APPENDIX A

Somerset West and Taunton Council

Capital, Investment and Treasury Strategies 2020/21 to 2024/25

Contents

Capital Strategy	Page 1
Investment Strategy	Page 28
Treasury Management Strategy	Page 37
Minimum Revenue Provision Statement	Page 59

Capital Strategy

1 Introduction

1.1 This Strategy document sets out Somerset West and Taunton Council's approach to capital investment. It provides an important framework and guiding principles that underpins its longer term capital investment plans, and forms part of the overarching corporate planning and financial strategy for the Council.

1.2 The Capital Strategy is part of the overarching financial governance framework, supporting strategic planning and financial strategy. It is included here together with closely related strategies in respect of investment and treasury management to provide a holistic view of capital, investment and borrowing requirements.

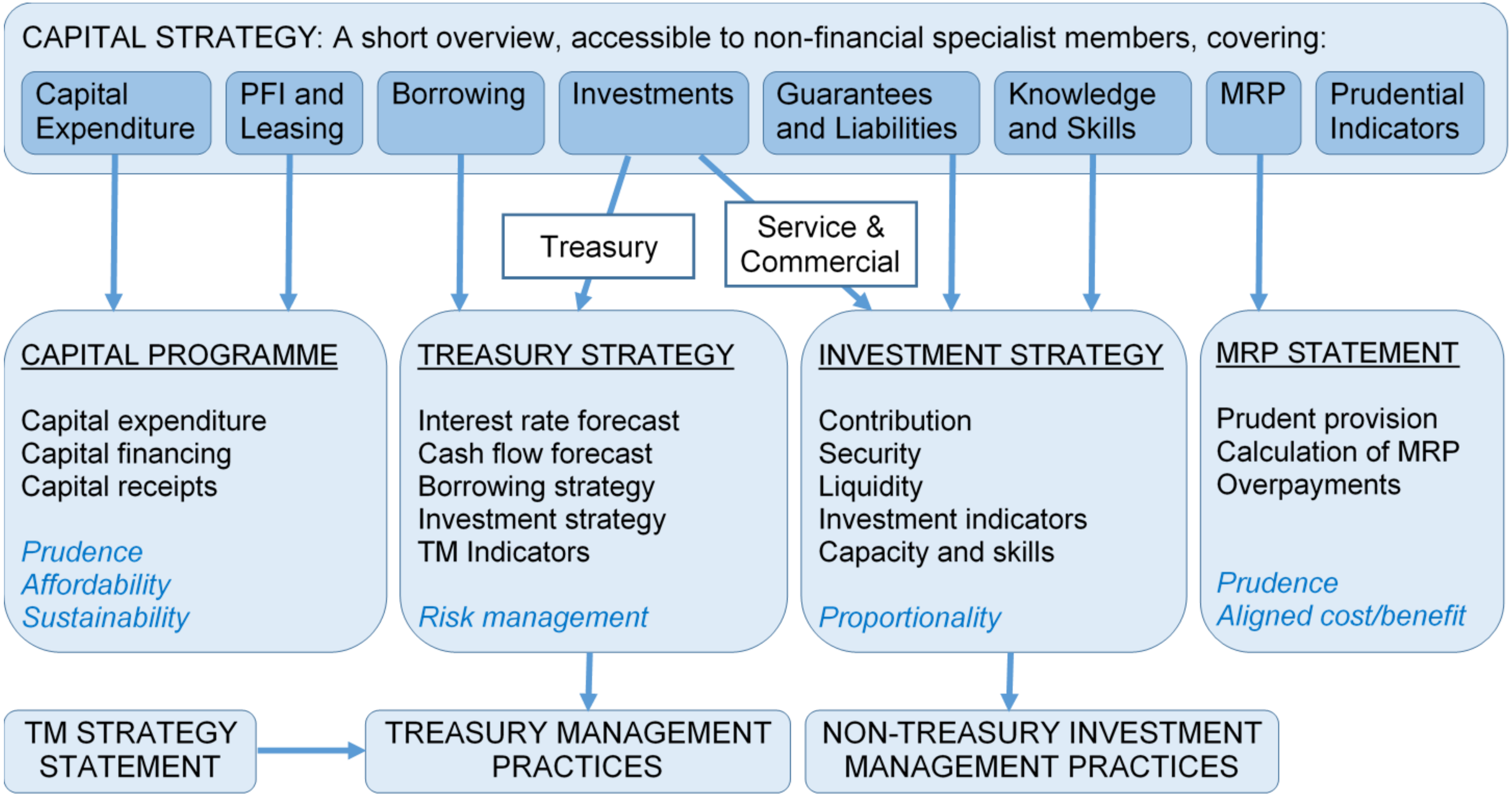
1.3 Somerset West and Taunton was created on 1 April 2019, with its assets, liabilities and functions transferred from the predecessor councils – Taunton Deane Borough Council and West Somerset District Council. Both Councils transferred a legacy borrowing requirement in respect of General Fund services however this represented a relatively low proportion of the value of capital assets transferred. In respect of Housing, TDBC transferred its Housing stock assets and associated borrowing requirement. Plans to meet the costs of the legacy borrowing requirement are embedded in both General Fund and Housing Revenue Account budgets and ongoing financial plans.

1.4 SWTC has recent and emerging plans that are expected to see a significant increase in capital investment both in the short term and longer term, related to housing, regeneration and commercial investment to generate essential income to fund local services and priority projects. This will see growth in assets held on the balance sheet and a related growth in borrowing need. The Council actively pursues access to other sources of capital such as bids for government grant funding, and private sector investment where appropriate, and plans to utilise the majority of available New Homes Bonus income and Community Infrastructure Levy towards the Capital Programme.

1.5 The strategy for capital schemes, particular in respect of growth and regeneration schemes, will continue to focus on opportunities for capital investment that at least covers its costs and where possible provides a positive revenue benefit.

1.6 The Council also forecasts and plans to hold prudent investment balances that will meet short term cash flow requirements and provide an ongoing investment income through proportionate strategic investment in pooled funds.

1.7 The following diagram represents the Capital Strategy framework and how the capital, investment, treasury and MRP approaches interlink.



2 Capital Expenditure

Capital Expenditure Estimates

2.1 Capital expenditure is incurred where the Council spends money on constructing or acquiring assets such as land and buildings including housing, vehicles, plant and equipment, which will be used for more than one year, as well as larger scale maintenance works that maintain or enhance the Councils existing assets. In local government capital expenditure can also include 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 as revenue expenditure in the year. This discretion is reflected in the Council's accounting policies which are set out within the Statement of Accounts each year.

2.2 The information included in the table below in respect of 2018/19 financial year relates to the two predecessor councils – Taunton Deane and West Somerset – included for comparative purposes. Budgets and estimates for 2019/20 onwards relate to Somerset West and Taunton Council, which came into being on 1 April 2019.

Table 1: Prudential Indicator – Actual and Estimates of Capital Expenditure

	2018/19 Actual £k	2019/20 Budget £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k	2024/25 Estimate £k	Totals 2019/20-2024/25 £k
General Services	17,709	69,215	13,603	7,338	4,893	4,673	1,673	119,104
Capital Investments	0	0	50,000	50,000	0	0	0	100,000
Housing services	11,379	23,093	15,844	12,133	11,625	15,719	14,719	104,512
Totals	**29,088**	**92,308**	**79,447**	**69,471**	**16,518**	**20,392**	**16,392**	**323,616**

2.3 The Council's capital investment focusses on the following main areas:

- Investment in new and existing operational assets and issuing capital grants to support the delivery of its services and strategic priorities. This includes schemes such as technology, regeneration and infrastructure projects, contributions to major transport and flood alleviation projects, and grants for accessibility adaptations and equipment to support independent living.

- Investment to grow and balance the Council's commercial investment income portfolio, as set out in the investment strategy. This may include direct property freehold or long-leasehold acquisition, as well as shareholdings and loans to third parties and subsidiaries.
- Investment in the Council's own housing provision by acquiring, building and improving its housing stock. This includes schemes such as the North Taunton housing regeneration programme, annual programme of additions to stock to deliver vital affordable housing in the district, and major works to maintain and improve our decent homes standards across the portfolio. This investment is funded through the Housing Revenue Account.

2.4 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.

2.5 Capital expenditure in 2020/21 may be updated due to a change in accounting for leases. If this proves to be the case an update will be included within the mid-year report.

Capital Programme

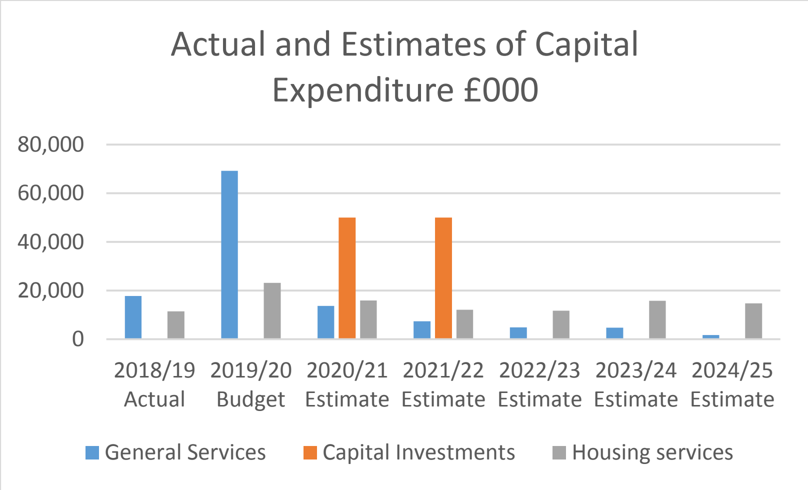
2.6 The Capital Programme represents the Council's commitment to continue to invest in its operational asset portfolio and wider investment to support housing, economy and place-shaping priorities. It is reviewed annually and approved through the budget setting process, taking into account the availability of capital resources and the financing cost implications on the revenue budget.

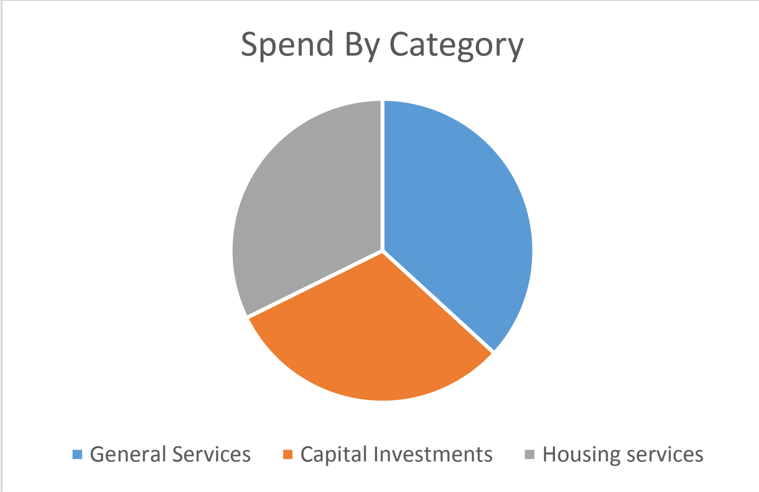
2.7 New capital schemes and projects are usually added to the Programme as part of the annual process, however the Council's governance arrangements allow for new schemes and projects to be added or removed from the programme during the year subject to appropriate approvals.

2.8 The annual programme is developed where managers bid in September/October for projects to be considered, with an outline scheme appraisal and specific funding proposals where appropriate. Bids are collated by Finance to summarise the potential expenditure requirement and assess the capital financing options. The programme is also informed by the Council's Asset Management Strategy and Plan, as well as strategic organisational development and improvement programmes.

2.9 The draft programme is presented initially to the Leadership team – Senior Officers and Executive Councillors, and priority proposals are then taken forward to Scrutiny Committee for review and comment. The Executive will then consider and recommend the final draft Capital Programme to Full Council for approval in February.

2.10 The proposed capital programme includes investment of £50.0m in 2020/21, with indicative further investment of £50.0m in the subsequent four years to 2024/25. The details of this investment is included in the General Fund and Housing Revenue Account 2020/21 Budget Estimates reports. The following charts provide an overview of the main areas of investment.





Asset Management

2.11 Following the formation of the new Council in April 2019 and the revision of the working structure in January 2020, the Asset Management Team falls within the designation of “Place” reporting directly to the Chief Executive and working closely with Development and Commercial Investment colleagues.

2.12 The Council has a core team of qualified property professionals who advise on acquisitions, disposals and day to day management of all Council assets.

2.13 The historic Asset Management Plans are presently under review and incorporate key Council priorities of delivering excellent customer service and identifying income generating investment opportunities. Properties considered for acquisition within the Corporate Investment Strategy are thoroughly reviewed, financial models run and due diligence undertaken. Potential acquisitions which meet the initial criteria are then presented to the Investment Panel and Investment Board for authorisation.

2.14 The assets already within the Council's ownership are actively managed on a day to day basis in order to minimise costs and risks and to maximise any receipts. An important aspect will be the identification of expenses and receipts to specific property assets to enable non-performing investments or properties with excessive costs to be identified and considered for disposal.

3 Capital Financing

3.1 The Council's capital investment falls within the scope of the CIPFA Prudential Code for Capital Finance in Local Authorities (the 'Prudential Code'), to which the Council must give due regard. The Code was last updated in 2017. Under the Prudential Code the Council has discretion over the funding of capital expenditure and the freedom to determine the level of borrowing it undertakes to deliver the Capital Programme.

3.2 All capital expenditure must be financed, and there are range of potential funding sources the Council may use including its own resources or externally:

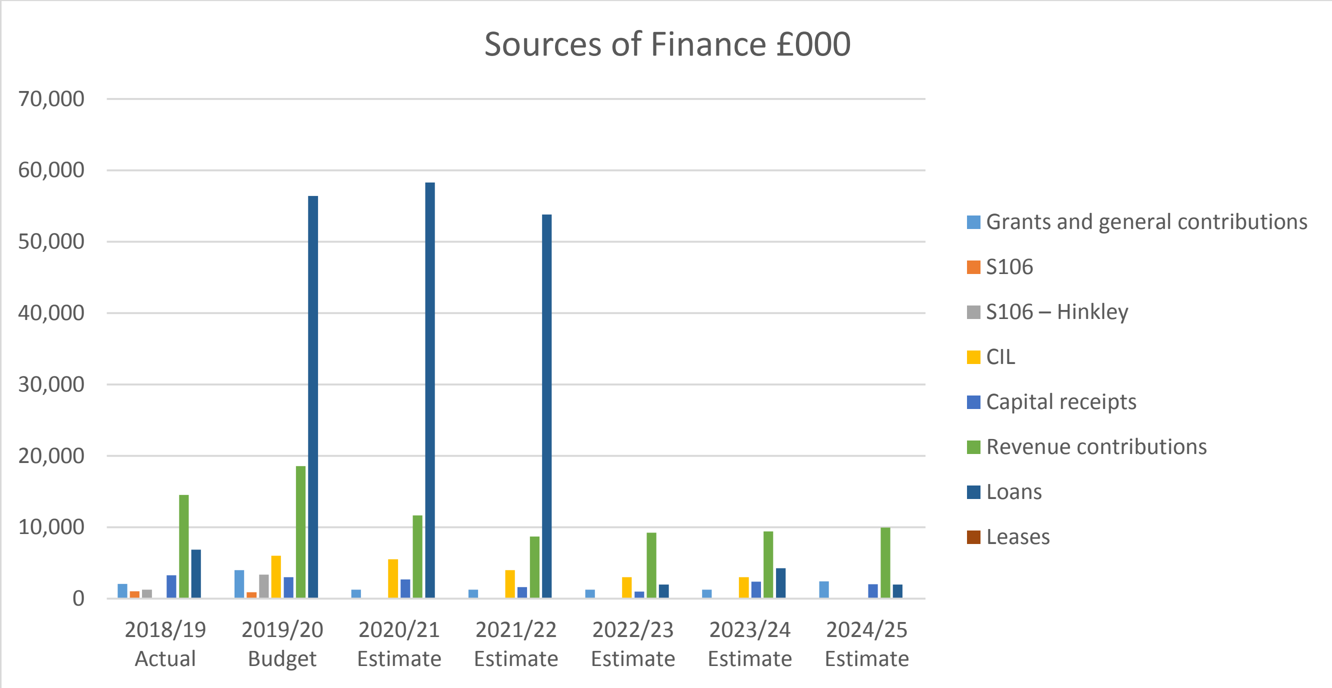
- Capital receipts from asset disposals and loan repayments
- Capital grants e.g. from Government or other local authorities
- Contributions from others e.g. Section 106 (S106) and Community Infrastructure Levy (CIL)
- Revenue Contributions to Capital e.g. from the Revenue Budget or Revenue Reserves
- Debt financing e.g. borrowing, capital market bonds, leasing

Capital Financing Plan

3.3 The planned financing of the capital expenditure in Table 1 above is as follows:

Table 2: Capital Financing Plan

	2018/19 Actual £k	2019/20 Budget £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k	2024/25 Estimate £k	Totals 2019/20-2024/25 £k
External Sources:								
Grants and general contributions	2,077	4,016	1,274	1,274	1,274	1,274	2,435	13,624
S106	1,025	913	0	0	0	0	0	1,938
S106 – Hinkley	1,263	3,351	0	0	0	0	0	4,614
CIL	0	6,000	5,500	4,000	3,000	3,000	0	21,500
Sub-total – External	**4,365**	**14,280**	**6,774**	**5,274**	**4,274**	**4,274**	**2,435**	**41,676**
Own Resources:								
Capital receipts	3,302	3,022	2,704	1,636	990	2,402	2,009	16,065
Revenue contributions	14,546	18,579	11,678	8,726	9,263	9,437	9,949	82,178
Sub-total - Own	**17,848**	**21,601**	**14,328**	**10,362**	**10,253**	**11,839**	**11,958**	**98,243**
Debt:								
Loans	6,875	56,427	58,291	53,835	1,991	4,279	1,999	183,697
Leases	0	0	0	0	0	0	0	0
Sub-total - Debt	**6,875**	**56,427**	**58,291**	**58,835**	**1,991**	**4,279**	**1,999**	**183,697**
Total	**29,088**	**92,308**	**79,447**	**69,471**	**16,518**	**20,392**	**16,392**	**323,616**



3.4 The allocation of resources may vary over time, for example, where additional income is achieved through asset sales or obtaining external funding. The plan is therefore dynamic, and is overseen by the Council's S151 Officer to optimise financing arrangements on an ongoing basis. The estimates will not commit the Council to particular methods of financing. The s151 Officer will determine the actual financing of capital expenditure incurred at the end of the financial year.

3.5 The implications of financing capital expenditure from borrowing is that the expenditure is not funded immediately but charged to the revenue budget over a number of years. The Council may defer the timing of external borrowing on a short to medium term by using temporary cash resources held in reserves and balances. This practice, which is referred to as 'internal borrowing', does not reduce the magnitude of borrowing required or the level of funds held in reserves and balances; the funds are merely being utilised in the short term until they are required for their intended purpose. The timing of external borrowing and the balance of external / internal borrowing is determined by market conditions and the Council's cash flow position. Officers manage this position on a day to day basis in line with the overall Treasury Management Strategy.

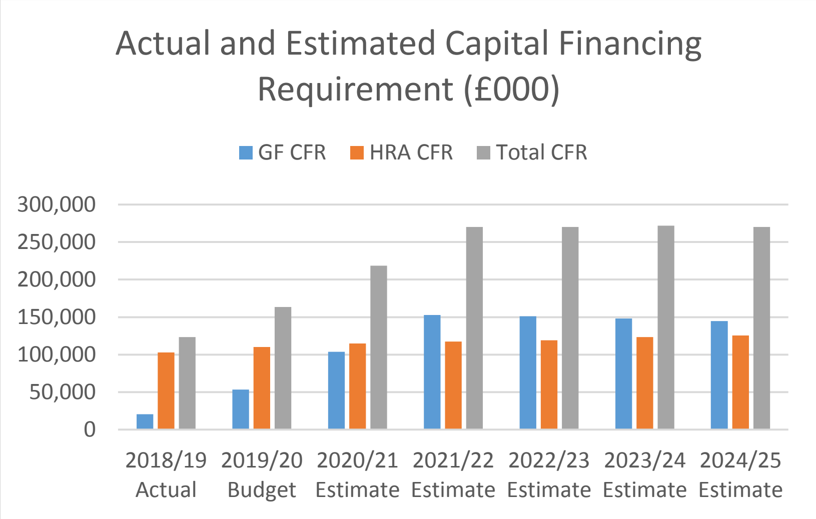
3.6 Debt is only a temporary source of finance, since loans and leases must be repaid and this is, therefore, replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). Alternatively, capital receipts may be used to replace debt finance.

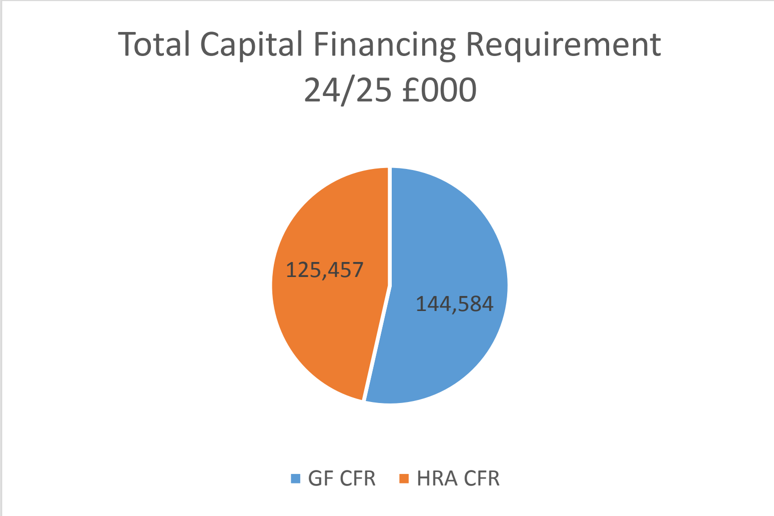
Capital Financing Requirement

3.7 The Council's cumulative amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP repayments and capital receipts used to replace debt. Based on the above figures for expenditure and financing the Council's estimated CFR is as follows:

Table 3: Prudential Indicator – Actual and Estimated Capital Financing Requirement

	2018/19 Actual £k	2019/20 Estimate £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k	2024/25 Estimate £k
General Fund							
CFR Balance b/f	14,402	20,455	53,334	103,745	152,859	151,024	148,274
Expenditure	17,709	69,215	63,603	57,338	4,893	4,673	1,673
MRP	-822	-455	-505	-945	-1,835	-2,750	-3,690
Capital receipts used to replace debt	-1,718	-3,022	-635	-455	0	0	0
Grants and Contributions	-9,116	-32,859	-12,052	-6,824	-4,893	-4,673	-1,673
Accounting adjustment - leases	0	0	0	0	0	0	0
GF CFR Balance c/f	20,455	53,334	103,745	152,859	151,024	148,274	144,584
HRA							
CFR Balance b/f	104,850	103,028	109,972	114,880	117,246	119,179	123,459
Expenditure	11,379	23,093	15,844	12,123	11,625	15,719	14,718
VRP	-1,821	-1,821	-1,821	-1,400	0	0	0
Capital receipts used to replace debt	-1,596	-3,675	-2,114	-1,181	-1,048	-2,402	-2,009
Grants and Contributions	-9,784	-10,653	-7,001	-7,176	-8,644	-9,037	-10,711
Accounting adjustment - leases	0	0	0	0	0	0	0
HRA CFR Balance c/f	103,028	109,972	114,880	117,246	119,179	123,459	125,457
Total CFR Balance	**123,483**	**163,306**	**218,625**	**270,105**	**270,203**	**271,733**	**270,041**





3.8 The capital financing requirement for 2020/21 and subsequent years does not currently include an adjustment due to a change in the accounting for leases, however the calculation will it be updated if necessary as part of the mid-year report.

3.9 The chart shows that the Council's proposed capital strategy and capital investment plans are expected to increase the overall indebtedness position of the next 5 years. It is important to ensure such plans are affordable and the Council can meet the costs of this debt over the short and long term. This strategy considers affordability through a range of measures, for example, in respect of the Housing Revenue Account debt-financed expenditure we have introduced an interest cover ratio (ICR) benchmark of 1.25 to ensure borrowing costs are affordable. Other measures are shown within the prudential indicators shown with the Treasury Management Strategy section of this report.

Grants and Contributions

3.10 The Council will seek to access external funding towards its capital investment plans where funds are available and our schemes are within scope. Examples of grants may include Government schemes such Housing Infrastructure Fund, Future High Streets Fund and so on. We also receive contributions from other bodies such as developers in the form of S106 planning obligations contributions and Community Infrastructure Levy (see below). It is often the case that the Council will need to put some of its own resources towards a scheme in order to attract the external funding. However this can be effective in levering in funds to enable larger infrastructure investments to progress and mitigate marginal viability schemes.

3.11 The balance of capital grants reserves transferred to SWTC on 1 April 2019 was £5.344m. Of this sum, £5.200m is committed to financing the current approved Capital Programme. Bids are usually a competitive process therefore expenditure is usually only built into the approved capital programme once the funding has been confirmed.

S106

3.12 S106 contributions are agreed as contributions towards certain obligations through planning approvals. Contributions that related to district council services within SWT are paid to the Council, and are usually restricted on the nature of costs that the funds can be used for, such as public art, play areas and equipment, affordable housing provision. S106 can be used to fund both revenue and capital costs and therefore allocated to capital and revenue budgets accordingly.

3.13 Decisions regarding the allocation of funds may be taken by the relevant budget holder for the expenditure for amounts up to £20k, by Head of Function/Director/CEO and S151 Officer up to £50k and Portfolio Holder and S151 Officer above £50k.

Hinkley Point S106

3.14 Under the planning agreement for the development of Hinkley Point C nuclear power station, significant mitigation funds have been paid by EDF to the Council as the planning authority. The funds are used to contribute to enhanced service costs and can also be used for capital projects.

3.15 Proposals for the allocation of funds to specific projects are considered by the Planning Obligations Board, who will make recommendations to the Executive for schemes up to £250k, and by Full Council for larger schemes.

Community Infrastructure Levy (CIL)

3.16 The Council operates an approved CIL policy, with the levy payable on development in certain areas within the District. CIL is recognised as capital income and therefore provides resources to contribute to eligible infrastructure investment such as transport/roads, education, town centre regeneration and flood alleviation schemes. 15% (or 25% with an adopted Neighbourhood Plan) of CIL income is passed to town or parish councils, and 5% is allocated to fund administration costs.

3.17 The Policy is approved by Council and implemented by Officers. Council determines the allocation of CIL income to investment themes as part of the annual capital programme approval process. The Executive Committee or Portfolio Holder for Asset Management and Economic Development may agree specific scheme allocations for projects >£250k, or the Development and Place Director for projects <£250k, within the limits allocated by Council to each theme. Expenditure to be funded by CIL is only committed once CIL income has actually been received.

Table 4: Estimated CIL Retained Income (Net of town/parish share and administration costs)

	2018/19 Actual £k	2019/20 Estimate £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k
Net CIL Income	3,628	4,666	2,732	2,913	2,439	2,360

Capital Receipts

3.18 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. Repayments of capital grants, loans and investments also generate capital receipts income.

3.19 The balance of capital receipts reserves transferred to SWTC on 1 April 2019 is £15.242m. Of this sum, £1.505m is committed to financing the current approved Capital Programme. The Council estimates it will receive £15.739m of capital receipts in the period 2019/20 to 2024/25 as set out below.

Table 5: Capital Receipts Income Estimates

	2018/19 Actual £k	2019/20 Estimate £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k	2024/25 Estimate £k
General Fund:							
Asset Disposals	1,028	1,093	1,375	2,050	0	0	0
Loans and Grants Repaid	0	0	0	0	0	0	0
Other	307	191	0	0	0	0	0
General Fund Total	**1,335**	**1,284**	**1,375**	**2,050**	**0**	**0**	**0**
HRA:							
Right to Buy Sales	2,334	2,798	2,069	1,139	990	1,733	1,733
Other	32	293	275	0	0	0	0
HRA Total	**2,366**	**3,091**	**2,344**	**1,139**	**990**	**1,733**	**1,733**
Total Receipts	**3,701**	**4,375**	**3,719**	**3,189**	**990**	**1,733**	**1,733**

3.20 The generation of capital receipts will be driven in part by the Asset Management Strategy, where the Council proposes a programme of proactive disposal of assets that are not performing to an acceptable level or are identified as surplus to requirements.

Flexible Use of Capital Receipts

3.21 In the Spending Review 2015, the Chancellor of the Exchequer announced that to support local authorities to deliver more efficient and sustainable services, the government will allow local authorities to spend up to 100% of their capital receipts from the sale of non-housing assets on revenue costs incurred to generate ongoing revenue savings, to reduce costs and / or transform service delivery in a way that reduces costs or demand for services in future years. This flexibility relates to expenditure which is properly incurred for the financial years 2016/17 to 2021/22.

3.22 Local authorities are only able to use capital receipts in the years in which this flexibility is offered. In using the flexibility, the Council will have due regard to the requirements of the Prudential Code, the CIPFA Local Authority Accounting Code of Practice and the current edition of the Treasury Management in Public Services Code of Practice. A flexible use of capital receipts policy will be presented to Council before the start of each financial year for which the flexibilities are proposed to be utilised, with the annual budget report.

3.23 TDBC and WSC previously agreed to utilise £3.135m (General Fund £1.975m, HRA £1.160m) of capital receipts income to support investment in transformation of services. As part of this strategy it is proposed to revise this plan to £2.2m for the whole 6 year period to 2021/22. For the period up to 31 March 2019, £1.134m has been used to fund eligible costs, and an additional £0.540m is budgeted to be used up to March 2022 as shown below. The total of £2.2m therefore includes c£0.5m of additional flexibility for further schemes in future that will contribute to financial sustainability of the Council. Detail regarding the proposed use of this funding is included in the Capital Programme, which will need to be underwritten by other resources if insufficient income is received.

Table 6: Flexible Use of Capital Receipts

	2016/17-2018/19 £k	2019/20 Estimate £k	2020/21 Estimate £k	2021/22 Estimate £k
General Fund Flexible Use of Capital Receipts	732	360	180	0
HRA Flexible Use of Capital Receipts	402	0	0	0
Total Flexible Use of Capital Receipts	**1,134**	**360**	**180**	**0**

Revenue Contributions to Capital

3.24 The Council proposes to support the financing of part of the Capital Programme through direct contributions of revenue funding. Annual contributions are determined through the setting of Capital Programme priorities and affordability within the Revenue Budget. Revenue contributions are predominantly directed towards recurring annual investments, with the advantage of reducing debt financing costs. Revenue Contributions are factored into the Revenue MTFP and the Capital Programme financing plan, as summarised in Table 2 above.

4 Treasury Management and Borrowing Strategy

4.1 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council’s spending needs while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing. The Council is typically cash rich in the short-term as revenue is earned 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 need.

4.2 Due to previous spending and financing decisions within the Council's predecessor authorities, £92.5m of external borrowing was transferred to the Council on 1 April 2019, together with treasury investments totalling £42.4m.

4.3 The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in the future. These objectives are often conflicting and the Council, therefore, seeks to strike a balance between cheaper short-term loans (currently available at around 0.75%-1%) and long term fixed rate loans where the future cost is known but higher (currently 2%-3.3%).

4.4 Council's do not borrow for specific assets and cannot use local authority assets as security. Borrowing is undertaken to meet the capital financing requirement as a whole (less any short term use of temporary cash balances).

Public Works Loans Board (PWLB)

4.5 A common source of borrowing for local authorities is the Treasury, through the Debt Management Office, which took over the responsibilities of the previous Public Works Loans Board (although the term PWLB is still commonly used). There are a number of advantages to using the PWLB as a source of borrowing, such as

- Funds can be accessed quickly – usually within 2-3 days of notice
- It is simple to arrange with limited time and effort required
- The Council does not require a credit rating
- Borrowing is not linked to any specific asset, but can provide the resources need to meet the overall capital financing requirement.

4.6 The PWLB currently offers a discounted 'certainty rate' at 0.2% below its standard rates, triggered by the Council completing an annual return to Government. It also offers a discounted 'infrastructure rate' which is 0.4% below its standard rate, which is subject to a competitive bidding process.

4.7 In October, in response to the Treasury's concern about growing total debt balances for local government, the PWLB standard and certainty rates were increased by 1% without notice. As a consequence the Council is more likely to explore alternative sources of long term finance such as issuing bonds to the capital markets (typically pension funds and insurance companies).

Total Debt Position

4.8 Projected levels of the Council's total outstanding external debt are shown below, compared with the CFR (as detailed above). Statutory guidance is that actual debt should remain below the CFR, except in the short-term. As can be seen from the Table the Council expects to comply with this in the medium term.

Table 7: Prudential Indicator – Gross Debt and the CFR

	2018/19 Actual £k	2019/20 Budget £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k	2024/25 Estimate £k
GF External Debt	10,000	0	50,000	100,000	100,000	100,000	100,000
HRA External Debt	82,500	82,500	79,000	75,500	65,500	60,500	53,500
In Year Borrowing Requirement *	30,983	80,806	89,625	94,605	104,703	111,233	116,541
Total Debt	**123,483**	**163,306**	**218,625**	**270,105**	**270,203**	**271,733**	**270,041**
General Fund CFR	20,455	53,334	103,745	152,859	151,024	148,274	144,584
HRA CFR	103,028	109,972	114,880	117,246	119,179	123,459	125,457
Total CFR	**123,483**	**163,306**	**218,625**	**270,105**	**270,203**	**271,733**	**270,041**

* In year borrowing requirement will either be funded by external borrowing or use of existing balances and reserves (internal borrowing).

Liability Benchmark

4.9 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 £30.0m at each year-end. This benchmark is currently forecast to be £41.5m at 31 March 2020 and is forecast to rise to £82.2m at 31 March 2025.

Table 8: Actual External Borrowing and the Liability Benchmark

	2018/19 Actual £k	2019/20 Budget £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k	2024/25 Estimate £k
Outstanding External Borrowing	92,500	82,500	129,000	175,500	165,500	160,500	153,500
Liability Benchmark	-27,608	41,506	55,325	60,305	70,403	76,933	82,241

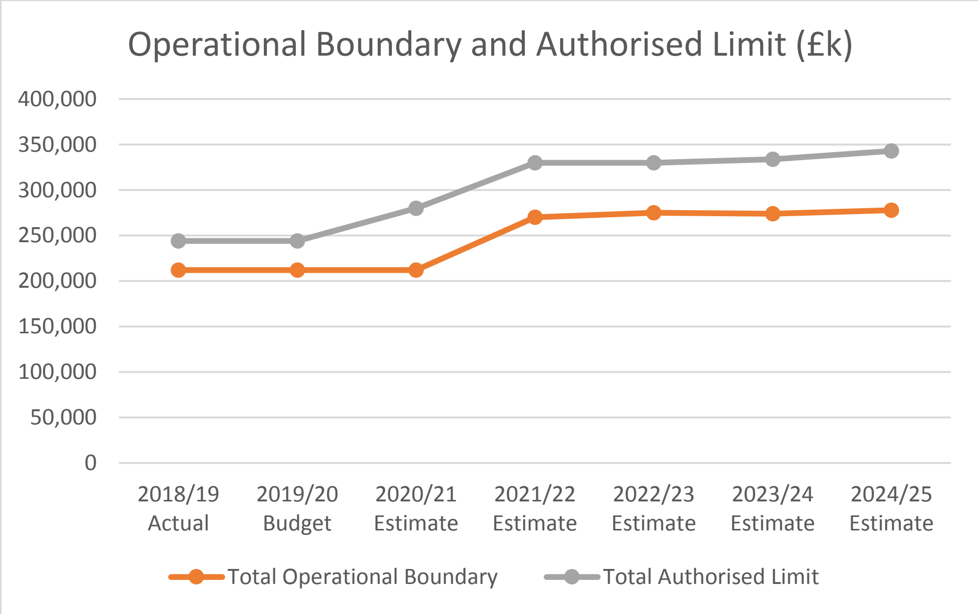
4.10 The table shows that the Council expects to remain borrowed above its liability benchmark. This is because cash outflows to date have been below the assumptions made. Further detail on the liability benchmark is included in the Treasury Management Strategy below.

5 Affordable Borrowing Limit

5.1 The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. In line with statutory guidance, a lower “operational boundary” is also set as a warning level should debt approach this limit. The Operational Boundary has been calculated based on the forecast CFR plus a tolerance for variations in spending plans during the year and possible volatility in availability of internal and external resources.

Table 9: Prudential Indicators – Authorised Limit and Operational Boundary for external debt

	2018/19 Actual £k	2019/20 Budget £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k	2024/25 Estimate £k
Operational Boundary:							
Borrowing	212,000	212,000	212,000	270,000	275,000	274,000	278,000
Leases							
Total Operational Boundary	**212,000**	**212,000**	**212,000**	**270,000**	**275,000**	**274,000**	**278,000**
Authorised Limit:							
Borrowing	244,000	244,000	280,000	330,000	330,000	334,000	343,000
Leases							
Total Authorised Limit	**244,000**	**244,000**	**280,000**	**330,000**	**330,000**	**334,000**	**343,000**
Memo – Indicative Authorised limits for GF and HRA:							
General Fund	128,000	128,000	125,000	175,000	175,000	175,000	175,000
HRA	116,000	116,000	155,000	155,000	155,000	159,000	168,000



5.2 The total borrowing limit applies to the combined borrowing requirement for the General Fund and the Housing Revenue Account. As borrowing is managed on a pooled basis for cash flow purposes the above limits relate to the whole-Council position. However, indicative splits between the GF and HRA are included as a memorandum item although not specifically required for the prudential indicator.

5.3 Further details of existing borrowing can be found in the Treasury Management Strategy Statement.

6 Investment Strategy

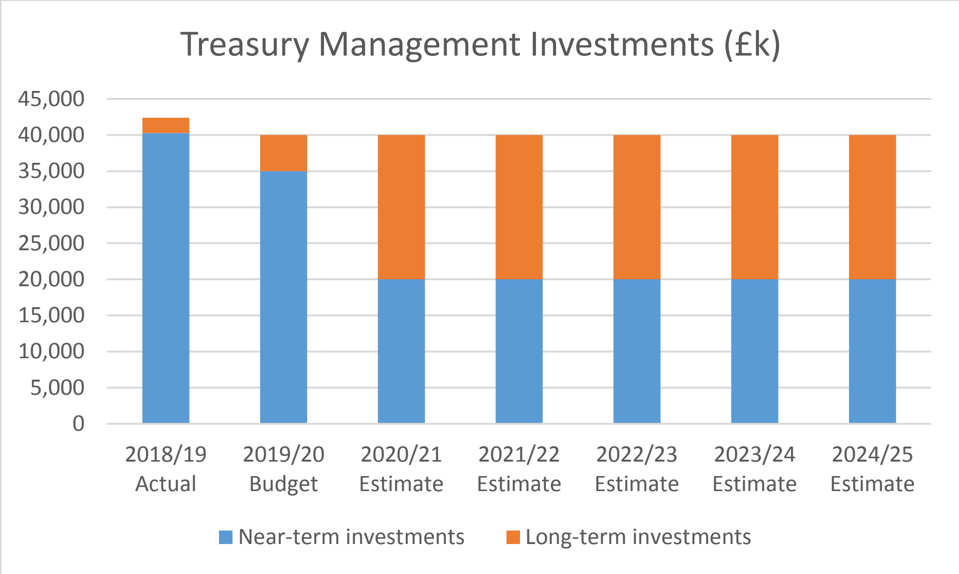
6.1 Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

6.2 The Council's policy on treasury investments is to prioritise security and liquidity over yield, therefore 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.

6.3 As part of the Council's financial strategy, the aim is to evolve the balance within the investment portfolio to improve the net income available through treasury management to fund services, whilst maintaining a prudent balance between security, liquidity and yield. Subject to long term cash flow forecasts, it is anticipated there will be an increase in funds held as longer term investments (although may normally be accessed within 2-3 months if required). As these may expose a proportion of funds to a higher risk of capital value volatility, the S151 Officer proposes to mitigate this by holding a risk-assessed minimum balance of funds in a Treasury Risk Reserve. The assessment of adequate general reserves also incorporates an element of risk to investment income assumptions.

Table 10: Treasury Management Investments

	2018/19 Actual £k	2019/20 Budget £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k	2024/25 Estimate £k
Near-term investments	40,267	35,000	20,000	20,000	20,000	20,000	20,000
Long-term investments	2,129	5,000	20,000	20,000	20,000	20,000	20,000
Total	**42,396**	**40,000**	**40,000**	**40,000**	**40,000**	**40,000**	**40,000**



6.4 Further details of existing treasury investments can be found in the Treasury Management Strategy below.

6.5 The effective management and control of risk are prime objectives of the Council's treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives may be used to manage treasury risks.

6.6 Decisions on treasury management and borrowing are made daily and are, therefore, delegated to the s151 Officer and his staff who must act in line with the Treasury Management Strategy approved by Full Council. Reports on treasury management activities are presented to the Audit Governance and Standards Committee mid-year and at year-end.

7 Investment for Service Purposes

7.1 The Council makes investments to assist local public services, including making loans to local small businesses to promote economic growth. Examples of current loans are included in the Investment Strategy below.

7.2 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 positive investment return after all costs are covered.

7.3 Decisions on service investments are made by the relevant service manager in consultation with the s151 officer and must meet the criteria and limits laid down in the investment strategy. Most loans are capital expenditure and purchases will, therefore, also be approved by Committee or through delegated powers as part of the capital programme.

7.4 Further details on service investments are contained in the Investment Strategy.

8 Commercial Investment 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 intends to diversify into investments in commercial property mainly for financial gain, primarily in order to provide an alternative income stream to fund services locally but also where appropriate for capital growth.

8.3 On 1 April 2019, investment properties valued at £21.70m were transferred to SWTC from its predecessor Councils, which generated a net yield of £0.80m in 2018/19.

8.4 The Council has agreed to increase its commercial investment activity over the next 2-3 years to help mitigate the reduction in central government financial support and avoid cuts to local services. 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. The underlying principles of a Property Investment Strategy imply, assume and default to nothing taking higher priority than 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 or shorter 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 borrowing.
- Risk: rate of return is one side of the coin; risk is the other. In general, the higher the sought level of return from an investment, the higher level of risk that it carries. For example, if a property is let at an attractive rent which would create a good return, it could still be risky if the tenant does not possess good covenant strength and could default at any time.
- 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.
- 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. Ideally 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 the district or functional economic area. This does not prevent investment outside of district, subject to the appropriate justification and business case and correct governance procedure. Equally, geographical diversification is an important factor in spreading portfolio risk.

- 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. Sector diversification is an important factor in spreading portfolio risk.
- Property 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. 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.

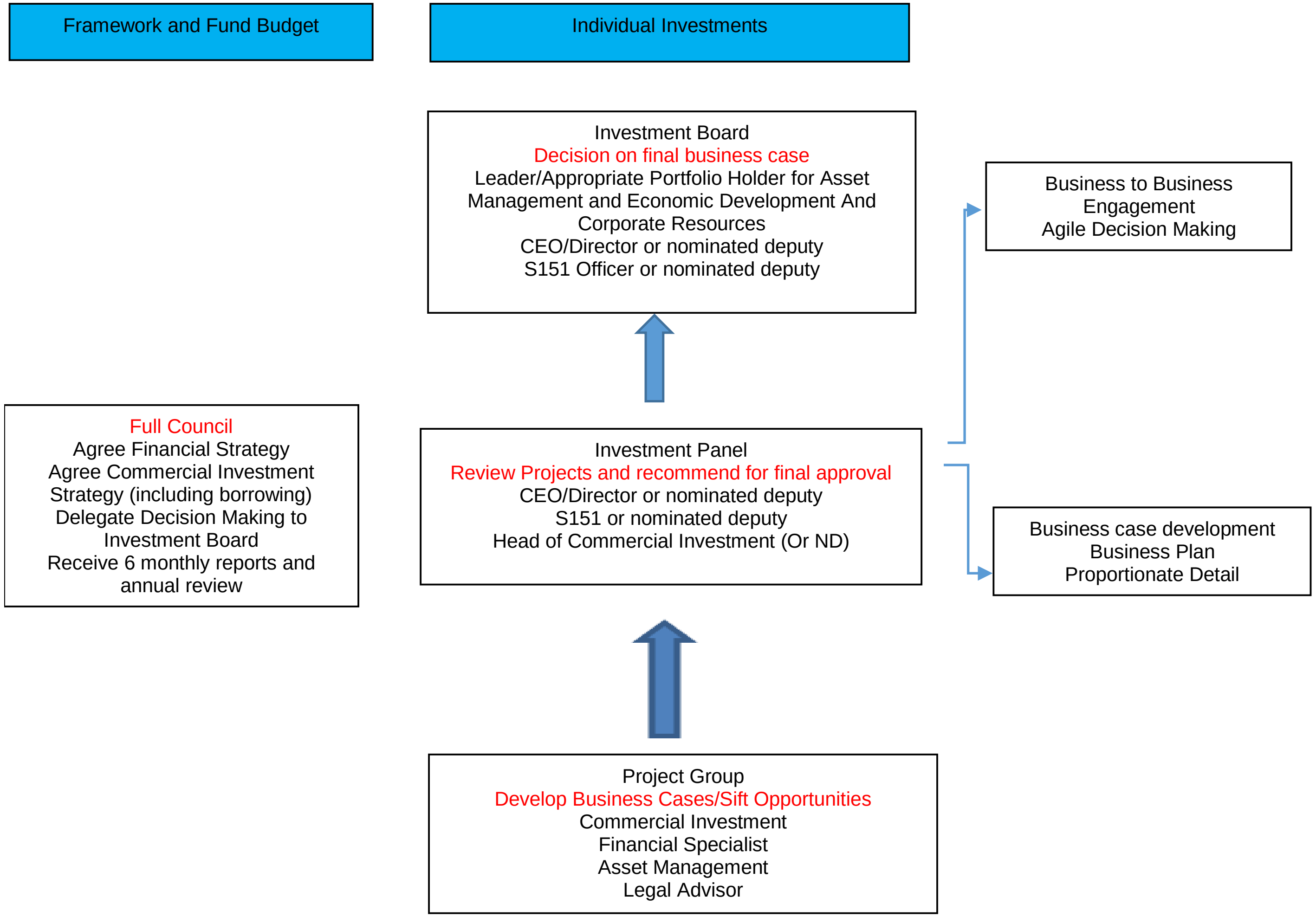
8.5 In summary the strategy for acquiring and managing the portfolio of investment property assets is therefore to:

- 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 MTFP.
- Identify opportunities for future growth, redevelopment or regeneration via property in commercially popular or development areas.
- Prioritise key towns in Somerset West and Taunton where this complements the portfolio risk balance, but pursue a geographical mix to spread risk.
- Pursue opportunities to increase returns and improve the investment value of commercial assets.

8.6 Environmental, Social and Governance (ESG) considerations - the Council has declared a policy objective of no direct investment in fracking, and seeking investment that does not conflict with its climate change priority. The aim is therefore to consider the Council’s principles and priorities around ethics, social value and the environment as part of the investment decision process.

8.7 Decisions on commercial investments are delegated by the Council to the Investment Board in line with the criteria and limits approved by Full Council in December 2019. Property and most other commercial investments are also capital expenditure and purchases will therefore be reported as part of the capital programme. Performance of the investment portfolio will be reported to the Executive and also be incorporated within the overall financial monitoring reports throughout the year.

Chart: Commercial Investment Governance Structure:



8.8 Investment decisions require unanimous agreement by all Board Members. Group Leaders may also nominate two members of the non-ruling Group to attend the Investment Board, without voting rights.

8.9 Further details on commercial investments and limits on their use are set out in the Investment Strategy.

9 Liabilities

9.1 In addition to capital debt as detailed above the Council is committed to making future payments to cover its pension deficit, which was valued at £105.70m on 1 April 2019. This balance is due to be paid over a 20 year period, and the deficit and annual contributions are revalued every three years. It has also set aside £3.50m to cover provisions for probable costs. The Council is also at risk of having to pay for contingent liabilities but has not put aside any money because payment is contingent on, as yet, unknown events occurring which may crystallise possible amounts due.

9.2 Decisions on incurring new discretionary liabilities are taken by senior managers and service managers in consultation with the s151 Officer. The risk of liabilities crystallising and requiring payment is monitored by the finance team and reported to the s151 Officer.

9.3 Further details on liabilities and guarantees can be found in the 2018/19 Statements of Accounts for Taunton Deane Borough Council and West Somerset Council. These transferred to Somerset West and Taunton Council on 1 April 2019.

10 Revenue Budget Implications

10.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans/leases and capital debt repayment provisions 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 11: Prudential Indicator – Proportion of financing costs to net revenue stream

	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Financing Costs (£m)	0.030	-0.018	-0.156	0.326	1.219	2.137	3.071
Proportion of Net Revenue Stream	0.15%	-0.08%	-0.74%	1.80%	6.60%	11.88%	16.44%

10.2 Financing costs for 2020/21 and subsequent years do not currently include an increase due to a change in the accounting for leases and will be updated if required as part of the mid-year report.

10.3 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 60 years into the future. The Strategic Finance Advisor and S151 Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable. 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 implications 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 MTFP.

11 Knowledge and Skills

11.1 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Strategic Finance Advisor and s151 Officer is a qualified accountant with many years' relevant experience. There are several other professionally qualified Finance Specialists within the Council's finance function, and the Council pays towards staff to study towards relevant qualifications including AAT and CCAB/CIMA. All officers involved in the treasury and investment management function have access to relevant technical guidance and training to enable them to acquire and maintain the appropriate level of expertise, knowledge and skills to undertake the duties and responsibilities allocated to them.

11.2 The Council also employs qualified property specialists / surveyors to manage land and property assets, and contribute to key asset decisions.

11.3 Legal specialist advice is provided to the Council through the SHAPE legal partnership.

11.4 Where council 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 and various property consultants as required. This approach is considered to be cost effective and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

11.5 Those charged with governance (Members of the Audit Governance and Standards Committee and the Executive) recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively. The Section 151

Officer will ensure that elected members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and responsibilities.

Investment Strategy

1 Introduction

1.1 The Council invests funds that it holds for three broad purposes:

i) 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**),

ii) to support local public services by lending to or buying shares in other organisations (**service investments**), and

iii) to earn investment income (known as **commercial investments** where this is the main purpose)

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

2 Treasury Management Investments

2.1 The Council typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA). The balance of treasury management investments is expected to fluctuate between £35m and £60m during the 2020/21 financial year.

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

2.3 Full details of the Council's policies and its plan for 2020/21 for treasury management investments are covered in the treasury management strategy later in this document.

3 Service Investments – Loans

3.1 The Council lends money to local businesses, local charities, other local authority partnerships, and local residents to support local public services and priorities, and stimulate local economic growth. Currently the Council has loans invested with:

- Somerset County Cricket Club – delivering the new Pavilion and bringing international cricket to Somerset.
- Great Western Hotel – regenerating a derelict building, and creating employment and training
- Hestercombe House and Gardens – enabling loan for development feasibility work
- Somerset Waste Partnership – for waste vehicles, with added benefit of keeping waste contract costs down
- Residents – housing related mortgages
- Centre for Outdoor Activity and Community Hub (COACH) – purpose built community centre including a café, conference suite, changing rooms, boat store and home to 5 community sports clubs

3.2 The Council also has agreements in place to provide loans to the Onion Collective CIC for the Watchet East Quay redevelopment scheme, and to Great Western Railway for improvements to Taunton Station. The Council has also included provision in its Capital Programme to provide further loan finance to the Somerset Waste Partnership for new vehicles, depot works and bins / boxes to deliver Recycle More under the new waste contract.

3.3 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 minimise this risk and ensure that total exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding loans to each category of borrower have been set as follows:

Table 12: Loans for Service Purposes

	Actual as at 31/03/2019			
Category of borrower	Balance Owing £k	Loss Allowance £k	Net Figure In Accounts* £k	2020/21 Approved Limit £k
Businesses	1,565	-31	1,534	7,000
Charities / Community Interest Company	39	-1	38	2,000
Local authorities	1,017	0	1,017	6,800
Residents	0	0	0	200
Total	**2,621**	**-32**	**2,589**	**16,000**

*The figures for the year ended 31 March 2019 are consolidated from TDBC and WSC Accounts.

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

3.5 The Council assesses the risk of loss before entering into and whilst holding service loans by working up a robust business case and applying due diligence to all requests for service loans, and proportionate monitoring of credit risk of borrowers. For example, with loans to key businesses the Council's finance specialist team (qualified accountants) will review financial statements and service officers will maintain communication with the borrower in order that emerging risks are identified promptly. The Council will use credit rating information where available, and will use external specialist advisors if appropriate.

4 Service Investments – Shares

4.1 The Council does not currently hold any direct investment in the shares of subsidiaries, its suppliers or local businesses. As part of the Council's commercialisation agenda, the Council may explore opportunities to establish wholly-owned or partly-owned trading companies. In any such case, appropriate business cases, due diligence, risk assessment and governance proposals will be developed for consideration of Full Council. In addition, relevant provisions would be added to the Investment Strategy including the expected contribution to the Council's strategies and priorities, and the security and liquidity of investments.

5 Commercial Investments – Property

5.1 The Council invests in a diverse investment property portfolio both locally and nationally with the intention of generating surplus income that will be spent on local public services delivered within the district. This is an essential response to significant reductions in government funding over recent years, in order to meet service delivery objectives and the place making role of the Council, and avoid service cuts. The council plans to increase its investment by up to £100m over the next 2-3 years.

5.2 The Council holds a number of assets that were initially acquired for service purposes such as benefitting the local economy but have since been reclassified as investment properties. These are now established and the main purpose for holding the assets is for rental income. The following table summarises the investment properties transferred to the Council on 1 April 2019 from TDBC and WSC.

Table 13: Properties held for investment purposes

	Value In Accounts As At 1 April 2019 £k
Thales Site, Lisieux Way, Taunton	1,608
Land used for Scrap Yard, Priory Way, Taunton	591
The Market House, The Parade, Taunton	1,626
Blackdown Business Park, Wellington (4 Units)	1,333
Ex Taunton Livestock Market, Priory Bridge Road, Taunton	12,553
Development Land at 3 Canal Road	480
The Arcade, Sea Front, Minehead	314
Roughmoor Enterprise Centre, Williton	1,399
All Others (Values under £250k)	1,767
Totals	**21,671**

5.3 In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs. The Council also recognises that asset values may increase and decrease over time due to market volatility, and takes a long term perspective with the assumption that capital values are likely to hold or grow over the life of the asset.

5.4 *Where value in accounts is at or above purchase cost:* A fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. Should the 2019/20 year end accounts preparation and audit process value these properties below their purchase cost, then an updated investment strategy will be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

5.5 The Council assesses the risk of loss before entering into and whilst holding property investments by undertaking appropriate due diligence including full valuation surveys and operating an asset management plan. The Council also considers strength of local market conditions to give confidence on future re-letting and also considers possible alternative uses if appropriate, and actively monitors the portfolio to ensure tenant obligations for maintaining assets are fulfilled.

5.6 Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Council actively manages cash flow through its treasury management arrangements and plans to under-borrow against its CFR so that it can temporarily borrow at short notice if required.

6 Financial Guarantees

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

6.2 The following guarantees were transferred to the Council from TDBC and WSC on 1 April 2019, as reported in the TDBC and WSC Statement of Accounts for 2018/19:

- Greenwich Leisure Limited Pension Liability (minimal – contract expired 31 July 2020)
- South West Audit Partnership Limited Pension Liability £0.268m (as at 31 March 2019)

7 Proportionality

7.1 The Council currently has a low dependency on investment property income, but with increased investment the Council plans to become dependent on income generating investment activity to achieve a balanced revenue budget. Table 14 below shows the extent to which the expenditure planned to meet the service delivery objectives and place making role of the Council is dependent on achieving the expected net income from investments over the lifecycle of the Medium Term Financial Plan. Should it fail to achieve the expected net income, the Council's contingency plans for continuing to provide these services including holding adequate funds in an earmarked Investment Risk Reserve as well as carrying adequate General Reserves. Budget estimates are also set using prudent assumptions about net income from the portfolio including an allowance for voids / non-collection.

Table 14: Proportionality of Investments

	2018/19 Actual £k	2019/20 Estimate £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k	2023/24 Estimate £k	2024/25 Estimate £k
Gross Service Expenditure	89,076	90,858	92,879	94,940	97,043	99,88	101,376
Investment Income	1,621	1,467	5,201	7,030	8,820	8,810	8,810
Proportion	1.82%	1.61%	5.60%	7.40%	9.09%	8.88%	8.69%

7.2 Investment income shown in the above table is the gross income included in the budget estimates, disregarding asset management and capital financing costs.

8 Borrowing In Advance of Need

8.1 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 Council has chosen not to follow this guidance and plans to borrow for this purpose because generating investment income is now essential to respond to the large scale reductions in grant funding from Government. The Council (and its predecessors) has already sought to mitigate this reduction through service cost reductions, combining into a single workforce followed by the creation of the single new council entity, and driving further efficiency by transforming how we work and effectively managing demand for services. Increasing income is also part of the strategy to mitigate the significant funding reductions.

9 Capacity, Skills and Culture

9.1 Officers involved in the investment making decision process are governed by internal procedures and processes and external statutory guidance in the form of the CIPFA Treasury Management Code and MHCLG Investment guidance. Internally limits are set in the annual Treasury Management Strategy Statement and the overriding Treasury Management Practices. The Council team dealing with investment assessments and management are professionally qualified and experienced in their field of property, finance and legal, with access to training as required. Specialist advice will also be bought in for non-traditional property investments as required.

9.2 Members on the Investment Board are responsible for the commercial and finance portfolios, and will have access to relevant commercial property training for example as provided by the LGA or CIPFA as well as being advised by professional specialists.

9.3 The Commercial Investment function will lead on business case development and engagement with the market, including negotiations for acquisitions and disposals, operating within parameters set by Council within the approved commercial strategy. The team is guided by the Strategic Finance Advisor and S151 Officer and other finance specialists on the prudential framework and guidance within which the Council operates.

9.4 The Council recognises that the governance arrangements for building and managing a commercial investment property portfolio needs to be agile, and appropriately resourced to enable opportunities to be assessed and investment decisions to be made quickly. Appropriate time is also allowed between offer/acceptance and completion to enable full due diligence and legal agreements to be finalised. Full Council is responsible for agreeing the strategy and total fund value, with delegated authority given to the Investment Board to approve individual transactions within the portfolio. The Board consists of the Leader and two Portfolio Holders, the Chief Executive, and S151 Officer, and two Members from the non-ruling group may attend but without voting rights. The Board is advised by an Investment Panel that reviews projects and recommends for approval, with individual opportunities assessed by a Project Group consisting of key specialists.

10 Investment Indicators

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

Total investment exposure:

10.2 This indicator shows the Council's total exposure to potential investment losses. It includes amounts the Council is contractually committed to lend but have yet to draw down and guarantees the Council has issued.

Table 15: Total Investment Exposure

	Actual 1/4/2019 £k	Forecast 31/3/2020 £k	Forecast 31/3/2021 £k	Forecast 31/3/2022 £k	Forecast 31/3/2023 £k
Treasury Management Investments – Strategic Funds	10,000	16,000	20,000	20,000	20,000
Treasury Management Investments – Other	32,396	24,000	20,000	20,000	20,000
Service Investments – Loans	2,596	2,196	1,796	1,396	996
Commercial Investment – Property	0	50,000	100,000	100,000	100,000
Total Investments	**44,992**	**92,196**	**141,796**	**141,396**	**140,996**
Commitments to Lend	7,500	11,577	12,500	12,500	12,500
Guarantees Issued on Pension Liabilities	268	268	268	268	268
Total Commitments and Guarantees	**7,768**	**11,845**	**12,768**	**12,768**	**12,768**
Total Exposure	**52,840**	**104,041**	**154,564**	**154,164**	**153,764**

How investments are funded:

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

Table 16: Investments funded by Borrowing

	Actual 1/4/2019 £k	Forecast 31/3/2020 £k	Forecast 31/3/2021 £k	Forecast 31/3/2022 £k	Forecast 31/3/2023 £k
Service Investments – Loans	2,596	2,196	1,796	1,396	996
Commercial Investment – Property	0	50,000	100,000	100,000	100,000
Commitments to Lend	7,500	11,577	12,500	12,500	12,500
Total Funded by Borrowing	**10,096**	**63,773**	**114,296**	**113,896**	**113,496**

Rate of return received:

10.4 The Council seeks to achieve a commensurate rate of return in line with this investment objectives and risk appetite. For service loans, the rate of return will be set with the aim of covering financing costs (or opportunity costs) plus a premium for risk. Arrangement. The target return on investment properties is commercially sensitive and therefore not disclosed, however the Council expects to offset its acquisition, financing and management costs and provide a net income to fund local services.

Other investment indicators:

10.5 The Government's investment guidance suggests authorities should consider a range of other quantitative indicators to show risks and opportunities in respect of investment and borrowing. The Council will therefore develop appropriate indicators and present these as part of the mid-year report.

Treasury Management Strategy

1 Introduction

1.1 Treasury management is the management of the Council's cash flows, borrowing and investments and the associated risks. The Council 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 finical risk are, therefore, central to the Council's prudent financial management.

1.2 Treasury risk management at the Council 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 Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.3 Investments held for service purposes and for commercial income generation are considered in the Investment Strategy above.

2 External Context

2.1 The treasury strategy appropriately considers the wider economic picture. The Council's treasury advisor – Arlingclose – has provided a summary commentary on this wider context and their own interest rate forecasts, which is provided in Appendix A.

3 Local Context

3.1 The Council's predecessor Council's transferred their investment and borrowing balances to Somerset West and Taunton Council on 1 April 2019. On 16 December 2019, the Council held £82.5m of borrowing and £46.7m of treasury investments. These balances are summarised below.

Table 17: Existing Debt and Investment Position

	1/4/2019 TDBC Balances Transferred £k	1/4/2019 WSC Balances Transferred £k	1/4/2019 SWTC Opening Balance £k	16/12/2019 SWTC Actual Portfolio £k
External Borrowing:				
Public Works Loan Board (PWLB)	-79,500	0	-79,500	-79,500
Barclays	-3,000	0	-3,000	-3,000
Portsmouth City Council	-10,000	0	-10,000	0
Total External Borrowing	**-92,500**	**0**	**-92,500**	**-82,500**
Treasury Investments:				
Banks and building societies (unsecured)	1,800	116	1,916	2,207
Covered bonds (secured)	2,128	0	2,128	2,062
Government including local authorities	0	12,042	12,042	7,540
Fixed Term Deposits	3,000	0	3,000	2,000
Money Market Funds	3,000	1,310	4,310	15,960
Corporate Funds and Multi Asset Investments	16,000	0	16,000	16,975
Certificates of Deposit	3,000	0	3,000	0
Total Treasury Investments	**28,928**	**13,468**	**42,396**	**46,744**
Net Debt	**-63,572**	**13,468**	**-50,104**	**-35,756**

3.2 Forecast changes in these sums are shown in the balance sheet analysis in Table 18 below.

Table 18: Balance Sheet Summary and Forecast

	1/4/2019 Actual £k	31/3/2020 Estimate £k	31/3/2021 Estimate £k	31/3/2022 Estimate £k	31/3/2023 Estimate £k	31/3/2024 Estimate £k
CFR – General Fund	20,455	53,334	53,745	52,859	51,024	48,274
CFR – HRA	103,028	109,972	114,880	117,246	119,179	123,459
CFR – Investments	0	0	50,000	100,000	100,000	100,000
Total CFR	**123,485**	**163,306**	**218,625**	**270,105**	**270,203**	**271,733**
Less: External Borrowing	-92,500	-82,500	-129,000	-175,500	-165,500	-160,500
Less: Other debt liabilities (leases)	0	0	0	0	0	0
Internal Borrowing	30,983	80,806	89,625	94,605	104,703	111,233
Less: Usable reserves	-50,438	-45,000	-40,000	-40,000	-40,000	-40,000
Less: Working capital surplus (-) / deficit	-18,153	-24,300	-24,300	-24,300	-24,300	-24,300
Treasury Investments (-) / New Borrowing	**-37,608**	**11,506**	**25,325**	**30,305**	**40,403**	**46,933**

3.3 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 investments. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

3.4 The Council has an increasing CFR due to the capital programme including anticipated investment property acquisition. The trend of increased expenditure indicates it will be required to borrow up to £46.93m over the forecast period.

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

Liability benchmark:

3.6 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 the same forecasts as table 18 above, but that cash and investment balances are kept to a minimum level of £30.0m at each year-end to maintain sufficient liquidity but minimise credit risk. This value is based on the advice received from Arlingclose, the Council's treasury management advisors.

Table 19: Liability benchmark

	1/4/2019 Actual £k	31/3/2020 Estimate £k	31/3/2021 Estimate £k	31/3/2022 Estimate £k	31/3/2023 Estimate £k	31/3/2024 Estimate £k
Total CFR	123,485	163,306	218,625	270,105	270,203	271,733
Less: External Borrowing	-92,500	-82,500	-129,000	-175,500	-165,500	-160,500
Less: Usable reserves	-50,438	-45,000	-40,000	-40,000	-40,000	-40,000
Less: Working capital	-18,153	-10,000	-24,300	-24,300	-24,300	-24,300
Plus: Minimum investments	10,000	30,000	30,000	30,000	30,000	30,000
Liability benchmark	**-27,608**	**41,506**	**55,325**	**60,305**	**70,403**	**76,933**

3.7 Following on from the medium-term forecasts in table 19 above, the long-term liability benchmark assumes capital expenditure funded by borrowing will need to increase by at least £77.0m by 2024 if spending forecasts are met, minimum revenue provision on new capital expenditure based on a 48 year weighted average asset life and income, expenditure and reserves all increasing by inflation of 2% a year.

4 Borrowing Strategy

4.1 The Council currently holds £82.50m of loans (as at 16 December 2019), compared to £92.50m on 1 April 2019, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 18 shows that the Council expects to borrow up to £50.00m in 2020/21. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £280.00m in 2020/21.

4.2 The Council'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 Council's long-term plans change is a secondary objective.

4.3 Given the significant cuts to public expenditure and in particular local government funding, the Council'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.

4.4 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and 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 Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council 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.

4.5 The Council (and its predecessors) 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 Council will now explore alternative options to borrow any long-term loans from other sources including banks, pensions 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.

4.6 Alternatively, the Council may arrange forward starting loans, 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 (although forward loan interest rates will usually factor in an allowance for interest rate risk during the intervening period).

4.7 Additionally, the Council may borrow further short term loans to cover unplanned cash flow shortages.

4.8 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
- Any other UK public sector body
- UK public and private pension funds (except Somerset County Pension Fund)
- Capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

4.9 Other sources of debt finance: 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

4.10 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 full Council.

4.11 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 interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

4.12 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 Council 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.

5 Treasury Investment Strategy

5.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the first six months of 2019/20 to 30th September 2019, the Council's investment balance has ranged between £38.30m and £60.40m, and similar levels are expected to be maintained in the forthcoming year.

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

5.3 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.

5.4 Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to further diversify into more secure and/or higher yielding asset classes during 2020/21. This is especially the case for the estimated £20.00m that is available for longer-term investment. A proportion of the Council's surplus cash is currently invested in short-term unsecured bank deposits, money market funds and other local authorities. This diversification will represent a continuation of the new strategy adopted in earlier years, with an enhanced opportunity to utilise strategic investment pooled funds as the resources of the two predecessor Councils are combined.

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

Approved Counterparties

5.6 The Council may invest its surplus funds with any of the counterparty types in table 20 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 20: 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	£5m 5 years	£9m 20 years	£9m 50 years	£5m 20 years	£5m 20 years
AA+	£5m 5 years	£9m 10 years	£9m 25 years	£5m 10 years	£5m 10 years
AA	£5m 4 years	£9m 5 years	£9m 15 years	£5m 5 years	£5m 10 years
AA-	£5m 3 years	£9m 4 years	£9m 10 years	£5m 4 years	£5m 10 years
A+	£5m 2 years	£9m 3 years	£5m 5 years	£5m 3 years	£5m 5 years
A	£5m 13 months	£9m 2 years	£5m 5 years	£5m 2 years	£5m 5 years
A-	£5m 6 months	£9m 13 months	£5m 5 years	£5m 13 months	£5m 5 years
None	£1m 6 months	n/a	£9m 25 years	£50k 5 years	£5m 5 years
Pooled funds and real estate investment trusts		Up to £7m each fund or trust			

5.7 **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. 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.

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

5.9 **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 generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

5.10 **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 or to a maximum of £2m per company as part of a diversified pool in order to spread the risk widely.

5.11 **Registered providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

5.12 **Pooled funds:** Shares or units 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.

5.13 Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council’s investment objectives will be monitored regularly.

5.14 **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

5.15 **Operational bank accounts:** The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £500,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

5.16 **Risk assessment and credit ratings:** Credit ratings are obtained and monitored by the Council'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

5.17 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 on the next working day 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.

5.18 **Other information on the security of investments**: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

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

Investment Limits

5.20 The Council's revenue reserves available to cover investment losses are forecast to be £28m on 31 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 £7m. 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 21: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£7m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£9m per group
Any group of pooled funds under the same management	£21m per manager
Negotiable instruments held in a broker’s nominee account	£21m per broker
Foreign countries	£9m per country
Registered providers and registered social landlords	£21m in total
Unsecured investments with building societies	£9m in total
Loans to unrated corporates	£9m in total
Money market funds	£42m in total
Real estate investment trusts	£21m in total

5.21 **Liquidity management**: The Council uses an in-house spreadsheet based cash flow forecasting model 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 Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council’s medium-term financial plan and cash flow forecast.

6 Treasury Management Indicators

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

Security

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

Credit risk indicator	Target
Portfolio average credit rating	A-

Liquidity

6.3 The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within 3 months	£20m

Interest Rate Exposures

6.4 This indicator is set to control the Council's exposure to interest rate risk. The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% rise in interest rates	£75,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£75,000

Maturity Structure of Borrowing

6.5 This indicator is set to control the Council's exposure to refinancing risk. The limits set for each category within this indicator is wide since the indicator is only to cover the risk of replacement loans being unavailable, not interest rate risk. 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. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Principal Sums Invested For Periods Longer Than a Year

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

Price risk indicator	2020/21	2021/22	2022/23
Limit on principal invested beyond year end	£30m	£25m	£25m

7 Related Matters

7.1 **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).

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

7.3 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.

7.4 In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

7.5 Housing Revenue Account: On 1 April 2012, the Council's predecessor (TDBC) 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 month and interest transferred between the General Fund and HRA at the Council's average interest rate on investments, adjusted for credit risk.

7.6 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 Council's treasury management activities, the S151 Officer believes this to be the most appropriate status.

8 Financial Implications

8.1 The budget for treasury investment income and debt interest in 2020/21 is summarised as follows:

Table 22: Interest Income and Costs Budget Estimates

Price risk indicator	**2020/21 Investment Income £k**	**2020/21 Interest Costs £k**	**2020/21 Net Income or Costs £k**
General Fund	-876	215	-661
Housing Revenue Account	0	2,745	2,745
Total	-876	2,960	2,084

8.2 If actual levels of investments and borrowing, or actual interest rates differ from those forecast, performance against budget will be correspondingly different. Significant variances will be identified in budget monitoring reports to the Senior Management Team and the Executive.

9 Other Options Considered

9.1 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The s151 Officer, having consulted the Portfolio Holder for Corporate Resources, 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

Alternative	Impact on income and expenditure	Impact on risk management
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

External Context – Commentary by Arlingclose (December 2019)

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. The General Election has removed some uncertainty within the market, however following the expected Withdrawal Bill, uncertainties around the future trading relationship with the EU remain.

GDP growth rose by 0.4% 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 1.1% from 1.2%. Services, construction and production added positively to growth, by 0.5%, 1.2% and 0.1% respectively, while agriculture recorded a fall of 0.1%. 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 headline rate of UK Consumer Price Inflation remained the same in November 2019 at 1.5% year-on-year, the same as October 2019, however continuing to fall from highs of 2.1% in July and April 2019 as accommodation services and transport continued to contribute to a level of inflation below the BOE target of 2%. Labour market data continues to be positive. The ILO unemployment rate continues to hold at historic lows at 3.8%, its lowest level since 1975. The 3-month average annual growth rate for pay excluding bonuses rose to 3.5% in November 2019 providing some evidence that a shortage of labour is supporting wages. However, adjusting for inflation this means real wages were only up by 0.9% in October 2019 and only likely to have a moderate impact on household spending.

Domestic inflationary pressures have abated, as domestic gas and electricity price freezes have taken effect until 2020. The price of oil has fallen through the year, despite a rise in prices in December 2019. The limited inflationary pressure from real wages will likely keep inflation below the Bank of England target of 2%. The Bank of England maintained Bank Rate to 0.75% in November 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 if there is a Brexit deal.

The US economy has continued to perform relatively well compared to other developed nations; however, the Federal Reserve has started to unwind its monetary tightening through 2019. The Federal Reserve has cut rates three times to 1.5% - 1.75%, to stimulate growth as GDP growth has started to fall (to 2.1%).

The fallout from the US-China trade war continues which, risks contributing to a slowdown in global economic activity in 2019. Recent suggestions have been an initial compromise and potential unwinding of tariffs; however, this can change quickly. Slow growth in Europe, combined with changes in leadership at the ECB and IMF has led to a change of stance in 2019. Quantitative easing has continued and been extended.

Credit outlook: The recent Bank of England stress tests assessed all seven UK banking groups. The tests scenarios include deep simultaneous recessions in the UK and global economies that are more severe overall than the global financial crisis, combined with large falls in asset prices and a separate stress of misconduct costs. All seven banks passed the test on both a CET1 ratio and a leverage ratio basis. Major Banks have steadily increased their capital for many years now. However, there are a number of shortcomings in the Bank's approach; timeliness as the results are over 11 months of out date when they are published, being based on end-2018 balance sheets; ringfencing, as the tests ignore the restrictions on transferring capital between ringfenced "retail" banks and non-ringfenced "investment" banks within the larger groups and; coverage – the tests should be expanded to cover a wider range of UK banks and building societies.

The Bank of England will seek to address some of these issues in 2020, when Virgin Money/Clydesdale will be added to the testing group and separate tests will be included of ringfenced banks.

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.

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 upcoming 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 November 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.

Arlingclose Economic & Interest Rate Forecast November 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.

- Brexit has been delayed until 31 January 2020. While the General Election has maintained economic and political uncertainty, the opinion polls suggest the Conservative position in parliament may be strengthened, which reduces the chance of Brexit being further frustrated. A key concern is the limited transitionary period following a January 2020 exit date, which will maintain and create additional uncertainty over the next few years.

- UK economic growth has stalled despite Q3 2019 GDP of 0.3%. Monthly figures indicate growth waned as the quarter progressed and survey data suggest falling household and business confidence. Both main political parties have promised substantial fiscal easing, which should help support growth.

- While the potential for divergent paths for UK monetary policy remain in the event of the General Election result, the weaker external environment severely limits potential upside movement in Bank Rate, while the slowing UK economy will place pressure on the MPC to loosen monetary policy. Indeed, two MPC members voted for an immediate cut in November 2019.

- Inflation is running below target at 1.7%. While the tight labour market risks medium-term domestically-driven inflationary pressure, slower global growth should reduce the prospect of externally driven pressure, although political turmoil could push up oil prices.

- Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- Although we have maintained our Bank Rate forecast at 0.75% for the foreseeable future, there are substantial risks to this forecast, dependant on General Election outcomes and the evolution of the global economy.

- Arlingclose judges that the risks are weighted to the downside.

- Gilt yields have risen but 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.

A summary of the forecast rates is included on the next page. Note:

- PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%

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

	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**

Minimum Revenue Provision (MRP) Statement

1 Policy Statement

1.1 Where the Council finances capital expenditure by debt, 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 Council to have regard to the Ministry of Housing, Communities and Local Government’s Guidance on Minimum Revenue Provision (the MHCLG Guidance) most recently issued in 2018.

1.2 The broad aim of the MHCLG 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.

1.3 The MHCLG Guidance requires the Council 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.

1.4 The predecessor Councils (TDBC and WSC) both adopted an MRP calculation method which spread the total Capital Financing Requirement over the weighted average useful life of each Council’s asset base on a straight line basis. The calculation took into consideration the materiality of each asset and its recorded remaining useful life. The weighted average was then applied to the class of asset then applied across the whole fixed asset base. That gave a robust basis to support the asset life applied to MRP calculations and be appropriate for audit scrutiny.

1.5 Following the creation of the Somerset West and Taunton Council on 1 April 2019, it is proposed to apply the same methodology for the opening balance General Fund CFR using the combined weighted average useful life of the consolidated asset base transferred to SWTC on 1 April. This is considered a prudent approach to charging for the legacy CFR transferred to SWTC from its predecessor Councils.

1.6 For capital expenditure incurred since 1 April 2019, the proposed methods for calculating MRP are as follows:

1.7 For Property Plant and Equipment (PPE) assets, MRP will be calculated over the weighted average useful life of each Council’s asset base at the start of each financial year on a straight line basis.

1.8 For assets acquired by leases or the Private Finance, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

1.9 For capital grants and contributions to third parties MRP will be calculated on a straight-line basis over 25 years from the 1 April following the year in which the grants or contributions are incurred.

1.10 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 the principal repayments to reduce the capital financing requirement in respect of those loans. 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. While this is not one of the options in the MHCLG Guidance, it is thought to be a prudent approach since it ensures that the capital expenditure incurred in the loan is fully funded over the life of the assets.

1.11 For Investment Properties, MRP will be calculated over 50 years, or over the professionally assessed useful life of the asset if lower than 50 years. MRP may be calculated using either annuity or straight-line basis as determined by the s151 Officer.

1.12 For Housing Revenue Account capital expenditure, MRP will be charged on a straight-line over 60 years.

1.13 MRP is charged based on the opening balance CFR carried forward from the previous year. Therefore Capital expenditure incurred during 2020/21 will not be subject to a MRP charge until 2021/22.

2 Capital Financing Requirement and MRP Estimates

2.1 Based on the Council’s latest estimate of its capital financing requirement (CFR) on 31 March 2020, the budget estimate for MRP has been set as follows:

Capital Financing Requirement and MRP / VRP	31/03/2020 Estimated CFR £k	2020/21 Estimated MRP / VRP £k
General Fund	53,334	505
Housing Revenue Account	109,972	1,821
Total	**163,306**	**2,326**

3 MRP Overpayments

3.1 Overpayments: In earlier years, the Council has made no voluntary overpayments of MRP that are available to reduce the revenue charges in later years. It is not planned to make an overpayment in 2020/21, however the s151 Officer may determine such an overpayment during the year and report this through the Outturn Report.

MRP Overpayments	£k
Actual balance 1 April 2019	0
Approved overpayment 2019/20	0
Expected balance 31 March 2020	0
Planned overpayment 2020/21	0
Forecast Overpayments Balance 31 March 2021	0