

North East Derbyshire District Council

Audit and Corporate Governance Scrutiny Committee

30 January 2020

Treasury Strategy Reports 2020/21 - 2023/24

Report of the Head of Finance and Resources

This report is public

Purpose of the Report

- To enable the Audit and Corporate Governance Scrutiny Committee to consider the attached treasury strategies prior to them being taken to Council for approval.

1 Report Details

- 1.1 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.
- 1.2 From 2019/20, the CIPFA Code requires that a Capital Strategy be produced alongside the Treasury Management Strategy. In addition, the 2018 Investment Guidance issued by the Ministry of Housing, Communities and Local Government requires local authorities to produce an investment Strategy. So there is now a requirement to produce three separate treasury strategies.
- 1.3 As in previous years, the Council's Treasury Management Strategy provides the framework for managing the Council's cash flows, borrowing and investments, and the associated risks for the years 2020/21 to 2023/24. The Treasury Management Strategy sets out the parameters for all borrowing and lending as well as listing all approved borrowing and investment sources. Prudential indicators aimed at monitoring risk are also included.
- 1.4 The Capital Strategy is intended to a high level, concise overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of the Council's services. The report also provides an overview of the associated risk, its management and the implications for future financial sustainability. The Capital Strategy sets out the capital expenditure plans for the period and how they will be financed. It also provides information of the minimum revenue provision, capital financing requirement and prudential indicators aimed at monitoring risk.

- 1.5 The Investment Strategy focuses on investments made for service purposes and commercial reasons, rather than those made for treasury management. Investments covered by this strategy include earning investment income through commercial investments or by supporting local services by lending to or buying shares in other organisations.

2 Conclusions and Reasons for Recommendation

- 2.1 This report outlines the Council's proposed suite of Treasury Strategies for the period 2020/21 to 2023/24 for consideration and approval by Council on 17 February 2020. It contains:

- The Treasury Management Strategy which provides the framework for managing the Council's cash flows, borrowing and investments for the period.
- The Capital Strategy which is intended to provide a high level, concise overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of the Council's services.
- The Investment Strategy which focuses on investments made for service purposes and commercial reasons, rather than those made for treasury management.

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

3 Consultation and Equality Impact

- 3.1 There are no equality issues arising from this report.

4 Alternative Options and Reasons for Rejection

- 4.1 Alternative options are considered throughout the

5 Implications

5.1 Finance and Risk Implications

- 5.1.1 These are considered throughout the report

5 Legal Implications including Data Protection

- 5.2.1 As part of the requirements of the CIPFA Treasury Management Code of Practice the Council is required to produce every year a Treasury Management Strategy and Capital Strategy which requires approval by full Council prior to the commencement of each financial year. This report is prepared in order to comply with these obligations.

- 5.2.2 There are no Data Protection issues arising directly from this report.

5.3 Human Resources Implications

5.3.1 There are no human resource implications arising directly out of this report.

6 Recommendations

- 6.1 That the Audit and Corporate Governance Scrutiny Committee note this report and the attached strategies and make any comments that they believe to be appropriate with regards to them.

7 Decision Information

Is the decision a Key Decision? A Key Decision is an executive decision which has a significant impact on two or more District wards or which results in income or expenditure to the Council above the following thresholds: <i>BDC: Revenue - £75,000 <input type="checkbox"/></i> <i> Capital - £150,000 <input type="checkbox"/></i> <i>NEDDC: Revenue - £100,000 <input type="checkbox"/></i> <i> Capital - £250,000 <input type="checkbox"/></i> <input checked="" type="checkbox"/> <i>Please indicate which threshold applies</i>	No
Is the decision subject to Call-In? (Only Key Decisions are subject to Call-In)	No
Has the relevant Portfolio Holder been informed	Yes
District Wards Affected	All
Links to Corporate Plan priorities or Policy Framework	All

8 Document Information

Appendix No	Title
1	Council report Treasury Management Strategy Capital Strategy Investment Strategy
Background Papers (These are unpublished works which have been relied on to a material extent when preparing the report. They must be listed in the section below. If the report is going to Cabinet (NEDDC) or Executive (BDC) you must provide copies of the background papers)	
Report Author	Contact Number
Jayne Dethick Head of Finance and Resources	01246 217078

AGIN 6(b) – Treasury Strategy

North East Derbyshire District Council

Council

17 February 2020

Treasury Strategy Reports 2020/21 - 2023/24

Report of Councillor P Parkin, Portfolio Holder for Finance

This report is public

Purpose of the Report

The purpose of this report is to provide Council with the necessary information to approve the Council's suite of Treasury Strategies for 2020/21 to 2023/24.

1 Report Details

- 1.1 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.
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- 1.4 The Capital Strategy is intended to provide a high level, concise overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of the Council's services. The report also provides an overview of the associated risk, its management and the implications for future financial sustainability. The Capital Strategy sets out the capital expenditure plans for the period and how they will be financed. It also provides information of the minimum revenue provision, capital financing requirement and prudential indicators aimed at monitoring risk (Appendix 2).

- 1.5 The Investment Strategy focuses on investments made for service purposes and commercial reasons, rather than those made for treasury management. Investments covered by this strategy include earning investment income through commercial investments or by supporting local services by lending to or buying shares in other organisations (Appendix 3).

2 Conclusions and Reasons for Recommendation

- 2.1 This report outlines the Council's proposed suite of Treasury Strategies for the period 2020/21 to 2023/24 for consideration and approval by Council. It contains:

- The Treasury Management Strategy which provides the framework for managing the Council's cash flows, borrowing and investments for the period.
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5.3 Human Resources Implications

- 5.3.1 There are no human resource implications arising directly out of this report.

6 Recommendations

6.1 It is recommended that Council approve the Treasury Management Strategy at Appendix 1 and in particular:

- a) Approve the Borrowing Strategy
- b) Approve the Investment Strategy
- c) Approve the use of the external treasury management advisors Counterparty Weekly List – or similar - to determine the latest assessment of the counterparties that meet the Council's Criteria before any investment is undertaken.
- d) Approve the Prudential Indicators

6.2 It is recommended that Council approve the Capital Strategy as set out in Appendix 2 and in particular:

- a) Approve the Capital Financing Requirement
- b) Approve the Minimum Revenue Provision Statement for 2020/21
- c) Approve the Prudential Indicators for 2020/21 detailed in the Capital Strategy, in particular:

Authorised Borrowing Limit	£199,485,000
Operational Boundary	£194,485,000
Capital Financing Requirement	£189,485,000

6.3 It is recommended that Council approve the Investment Strategy as set out in Appendix 3.

7 Decision Information

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Capital - £250,000 <input type="checkbox"/>	
<input checked="" type="checkbox"/> Please indicate which threshold applies	
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2	Capital Strategy
3	Investment Strategy
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Report Author	Contact Number
Jayne Dethick Head of Finance and Resources	01246 217078

North East Derbyshire District Council

Treasury Management Strategy 2020/21 – 2023/24

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 financial 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 or for commercial profit are considered in a different report, the investment Strategy.

External Context

- 1.4 **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 Council's treasury management strategy for 2020/21.
- 1.5 UK Consumer Price Inflation (CPI) for September registered 1.7% year on year, unchanged from the previous month. Core inflation, which excludes the more volatile components, rose to 1.7% from 1.5% in August. The most recent labour market data for the three months to August 2019 showed the unemployment rate ticked back up to 3.9% while the employment rate was 75.9%, just below recent record-breaking highs. The headline 3-month average annual growth rate for pay was 3.8% in August as wages continued to rise steadily. In real terms, after adjusting for inflation, pay growth increased 1.9%.

- 1.6 GDP growth rose by 0.3% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate of 1.0% from 1.2%. Services and construction added positively to growth, by 0.6% and 0.4% respectively, while production was flat and agriculture recorded a fall of 0.2%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.
- 1.7 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.
- 1.8 Growth in Europe remains soft, driven by a weakening German economy which saw GDP fall -0.1% in Q2 and is expected to slip into a technical recession in Q3. Euro zone inflation was 0.8% year on year in September, well below the European Central Bank's target of 'below, but close to 2%' and leading to the central bank holding its main interest rate at 0% while cutting the deposit facility to -0.5%. In addition to maintaining interest rates at ultra-low levels, the ECB announced it would recommence its quantitative easing programme from November.
- 1.9 In the US, the Federal Reserve began easing monetary policy again in 2019 as a pre-emptive strike against slowing global and US economic growth on the back of the ongoing trade war with China. At its last meeting the Fed cut rates to the range of 1.50-1.75% and financial markets expect further loosening of monetary policy in 2020. US GDP growth slowed to 1.9% annualised in Q3 from 2.0% in Q2.
- 1.10 **Credit outlook:** Credit conditions for larger UK banks have remained relatively benign over the past year. The UK's departure from the European Union was delayed three times in 2019 and while there remains some concern over a global economic slowdown, this has yet to manifest in any credit issues for banks. Meanwhile, the post financial crisis banking reform is now largely complete, with the new ring-fenced banks embedded in the market.
- 1.11 Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers.
- 1.12 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.

- 1.13 **Interest rate forecast:** The Council'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.
- 1.14 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.
- 1.15 A more detailed economic and interest rate forecast provided by Arlingclose is attached at **Appendix A**.
- 1.16 For the purpose of setting the budget, it has been assumed that new treasury management investments will be made at an average rate of 0.51%, and that new long-term loans will be borrowed at an average rate of 0.00%.

Local Context

- 1.17 On 31st December 2019, the Council held £150m of borrowing and £34.5m of investments. This is set out in further detail at **Appendix B**. Forecast changes in these sums are shown in the balance sheet analysis in **Table 1** below.

Table 1: Balance sheet summary and forecast

	31/3/19 Actual £m	31/3/20 Estimate £m	31/3/21 Forecast £m	31/3/22 Forecast £m	31/3/23 Forecast £m	31/3/24 Forecast £m
General Fund CFR	11.6	13.1	17.7	20.9	17.9	14.6
HRA CFR	172.4	172.1	171.8	170.0	168.1	166.4
Total CFR	184.0	185.2	189.5	190.9	186.0	181.0
Less: Other debt liabilities *	0	0	0	0	0	0
Less: External borrowing **	(150.8)	(149.5)	(149.2)	(147.0)	(146.9)	(144.8)
Internal borrowing	33.4	35.7	40.3	43.9	39.1	36.2
Less: Usable reserves	(53.5)	(51.3)	(50.9)	(52.9)	(48.6)	(45.2)
Less: Working capital (balance)	0.1	(1.9)	(1.1)	(1.0)	(0.5)	(1.0)
Investments	20.0	17.5	11.7	10.0	10.0	10.0

* leases that form part of the Council's total debt.

** shows only loans to which the Council is committed and excludes optional refinancing

1.18 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

1.19 The Council has an increasing CFR due to commitments within the capital programme and also loans for Northwood Group Ltd and Rykneld Homes Ltd. The forecast level of reserves means that the majority of borrowing throughout this period is likely to be from internal resources.

1.20 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 during 2019/20.

1.21 **Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk

level of borrowing. This assumes the same forecasts as **Table 1** above, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 2: Liability benchmark

	31/3/19 Actual £m	31/3/20 Estimate £m	31/3/21 Forecast £m	31/3/22 Forecast £m	31/3/23 Forecast £m	31/3/24 Forecast £m
CFR	184.0	185.2	189.5	190.9	186.0	181.0
Less: Usable reserves	(53.5)	(51.3)	(50.9)	(52.9)	(48.6)	(45.2)
Plus: Working capital	0.1	(1.9)	(1.1)	(1.0)	(0.5)	(1.0)
Plus: Minimum investments	10.0	10.0	10.0	10.0	10.0	10.0
Liability Benchmark	140.6	142.0	147.5	147.0	146.9	144.8

Borrowing Strategy

1.22 The Council currently holds £150m of loans, a decrease of £1m on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in **Table 1** shows that the Council does not expect to need to borrow in 2020/21. The Council may however, borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £199.485m.

1.23 **Objectives:** 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.

1.24 **Strategy:** Given the significant cuts to public expenditure and in particular to 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.

1.25 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 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 2019/20 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

- 1.26 The Council has previously raised all 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 look 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.
- 1.27 Alternatively, the Council may arrange forward starting loans during 2020/21, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.
- 1.28 In addition, the Council may borrow short-term loans to cover unplanned cash flow shortages.
- 1.29 **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:
- Public Works Loan Board (PWLB) and any successor body
 - any institution approved for investments (see below)
 - any other bank or building society authorised to operate in the UK
 - any other UK public sector body
 - UK public and private sector pension funds (except Derbyshire County Council Pension Fund)
 - capital market bond investors
 - UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues
- 1.30 **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
- 1.31 The Council has previously raised all of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.
- 1.32 **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 Council.

- 1.33 **LOBOs:** The Council doesn't hold or intend to hold any LOBO (Lender's Option Borrower's Option) loans.
- 1.34 **Short-term and variable rate loans:** These loans leave the Council 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).
- 1.35 **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. 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.

Investment Strategy

- 1.36 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the period 1 April 2019 and 31 December 2019, the Council's investment balance has ranged between £17.0m and £34.5m, and similar levels are expected to be maintained in the forthcoming year.
- 1.37 **Objectives:** 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.
- 1.38 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.
- 1.39 **Negative interest rates:** If the UK enters into a recession in 2020/21, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

1.40 **Strategy:** 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. The majority of the Council's surplus cash is currently invested in short-term unsecured bank deposits, local authorities and money market funds. This diversification will represent a continuation of the strategy currently adopted.

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

1.42 **Approved counterparties:** The Council may invest its surplus funds with any of the counterparty types in **Table 3** below, subject to the cash limits (per counterparty) and the time limits shown.

Table 3: Approved investment counterparties and limits

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£5m 50 years	n/a	n/a
AAA	£5m 5 years	£5m 20 years	£5m 50 years	£5m 20 years	£5m 20 years
AA+	£5m 5 years	£5m 10 years	£5m 25 years	£5m 10 years	£5m 10 years
AA	£5m 4 years	£5m 5 years	£5m 15 years	£5m 5 years	£5m 10 years
AA-	£5m 3 years	£5m 4 years	£5m 10 years	£5m 4 years	£5m 10 years
A+	£2.5m 2 years	£5m 3 years	£5m 5 years	£2.5m 3 years	£5m 5 years
A	£2.5m 13 months	£5m 2 years	£5m 5 years	£2.5m 2 years	£5m 5 years
A-	£2.5m 6 months	£5m 13 months	£5m 5 years	£2.5m 13 months	£5m 5 years
None	n/a	n/a	£5m 25 years	n/a	£5m 5 years
Pooled funds and real estate investment trusts	£5m per fund				

- 1.43 **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.
- 1.44 **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.
- 1.45 **Banks secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.
- 1.46 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities, Parish Councils 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.
- 1.47 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment as part of a diversified pool in order to spread the risk widely.
- 1.48 **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. As providers of public services, they retain the likelihood of receiving government support if needed.
- 1.49 **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.

1.50 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.

1.51 **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.

1.52 **Operational bank accounts:** The Council may incur operational exposures, for example through 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 at £5m 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.

1.53 **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.

1.54 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.

- 1.55 **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.
- 1.56 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.
- 1.57 **Investment limits:** In order to minimise investments that 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 £5m. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£5m each
UK Central Government	£5m in total
Any group of organisations under the same ownership	£5m per group
Any group of pooled funds under the same management	£5m per manager
Negotiable instruments held in a broker's nominee account	£5m per broker
Foreign countries	£5m per country
Registered providers and registered social landlords	£5m per provider
Unsecured investments with building societies	£5m in total
Loans to unrated corporates	£5m in total
Money market funds	£5m in total
Real estate investment trusts	£5m in total
Lloyds Bank (as providers of operational banking services)	£5m overnight

- 1.58 **Liquidity management:** The Council uses its own cash flow forecasting techniques 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.

Treasury Management Indicators

- 1.59 The Council measures and manages its exposures to treasury management risks using the following indicators:
- 1.60 **Interest rate exposures:** This indicator is set to control the Council's exposure to interest rate risk. 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 each year
Upper limit on one-year revenue impact of a 1% <u>rise</u> in interest rates	£1.5m
Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates	(£1.5m)

- 1.61 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.
- 1.62 **Maturity structure of borrowing:** This indicator is set to control the Council's exposure to refinancing risk. This indicator used to be for fixed rate borrowing only but now includes all borrowing. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	40%	0%
10 years and above	90%	0%

- 1.63 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.

Related Matters

- 1.64 The CIPFA Code requires the Council to include the following in its treasury management strategy.
- 1.65 **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).
- 1.66 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.
- 1.67 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.

- 1.68 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.
- 1.69 **Housing Revenue Account (HRA):** Following the budget on 30 October 2018, the legislation that capped the amount of HRA debt a local housing authority could hold was revoked with immediate effect. The capital financing requirements relating to the HRA will remain the same so there is still no requirement for an MRP and levels of debt will be managed through prudential borrowing limits controlled by this strategy to ensure that all additional borrowing is prudent and affordable within the context of the HRA. This should include:
- affordability over the life of the 30 year business plan;
 - a clear case for demand/need in the district;
 - generation of additional income.
- 1.70 A business case should be presented for consideration in each instance. As currently, all borrowing will continue to need Council approval.
- 1.71 Removing the debt cap and not having a statutory requirement to make a provision to repay debt presents a significant risk to the HRA. Very careful treasury management is needed to ensure that the Council's HRA borrowing remains affordable, prudent and reasonable and that the HRA remains sustainable over the long term. As a result, it is also prudent to consider having a voluntary debt cap and this is currently under review.
- 1.72 **Markets in Financial Instruments Directive:** The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.
- 1.73 **Financial Implications:** The General Fund budget for investment income in 2020/21 is £0.055m with the HRA budget for investment income in 2020/21 being £0.085m, based on an average investment portfolio of £16.7m at an interest rate of 0.83%. The General Fund budget for debt interest paid in 2020/21 is £0.063m with the HRA budget for debt interest paid in 2020/21 being £5.212m, based on an average debt portfolio of £149.5m at an average interest rate of 3.52%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

Appendix A

Economic & Interest Rate Forecast (Arlingclose 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 transitional 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 the 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.

	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

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

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

Appendix B

Existing Investment & Debt Portfolio Position

	31/12/19 Actual Portfolio £m	31/12/19 Average Rate %
External borrowing:		
Public Works Loan Board	150	3.52
Total external borrowing	150	3.52
Total other long-term liabilities:	0	0
Total gross external debt	150	3.52
Treasury investments:		
Banks & building societies (unsecured)	15	0.37
Government (incl. local authorities)	4.5	0.65
Money Market Funds	15	1.39
Total treasury investments	34.5	0.84
Net debt	115.5	



North East Derbyshire District Council

Capital Strategy 2020/21 – 2023/24

Introduction

- 1.1 This capital strategy report for 2020/21, gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability.
- 1.2 Decisions made this year on capital and treasury management will have financial consequences for the Council for many years into the future. They are therefore subject to both a national regulatory framework and to a local policy framework, summarised in this report.

Capital Expenditure and Financing

- 1.3 Capital expenditure is where the Council spends money on assets, such as property or vehicles that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below £10,000 are not capitalised and are charged to revenue in year.

In 2020/21, the Council is planning capital expenditure of £15.8m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure

	2018/19 Actual £m	2019/20 Forecast £m	2020/21 Budget £m	2021/22 Budget £m	2022/23 Budget £m	2023/24 Budget £m
General Fund services	1.7	3.7	3.7	3.2	1.2	1.1
Council housing (HRA)	13.0	13.0	12.1	9.5	9.5	9.5
Capital investments	0	0	0	0	0	0
TOTAL	14.7	16.7	15.8	12.7	10.7	10.6

Currently, there is no change in capital expenditure for 2020/21 for the change in accounting practice for leases but this will remain under review.

- 1.4 The main General Fund capital projects include replacement vehicles, asset refurbishment, ICT replacement and disabled facilities grants.
- 1.5 The Housing Revenue Account (HRA) is a ring-fenced account which ensures that council housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded separately.
- 1.6 **Governance:** Projects are included in the capital programme as part of the annual budget review or through ad hoc approval during the year. The capital programme is refreshed each year and the new requirements are presented to Cabinet and Council each February. Full details of the Council's Capital Programme can be seen at **Appendix A** to this report.
- 1.7 All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing and leasing). The planned financing of the above expenditure is as follows:

Table 2: Financing of Capital Programme

	2018/19 Actual £m	2019/20 Forecast £m	2020/21 Budget £m	2021/22 Budget £m	2022/23 Budget £m	2023/24 Budget £m
External sources	1.9	0.8	0.4	0.4	0.4	0.4
Own resources	11.6	13.0	11.7	10.1	10.1	10.0
Debt	1.2	2.9	3.7	2.2	0.2	0.2
TOTAL	14.7	16.7	15.8	12.7	10.7	10.6

- 1.8 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, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance. Planned MRP and use of capital receipts are as follows:

Table 3: MRP and Use of Capital Receipts to Repay Existing Debt

	2018/19 Actual £m	2019/20 Forecast £m	2020/21 Budget £m	2021/22 Budget £m	2022/23 Budget £m	2023/24 Budget £m
Own resources	2.9	4.4	2.7	2.9	2.9	2.9

The Council's full minimum revenue provision statement is **Appendix B** to this report.

- 1.9 The Council's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The CFR is expected to increase by £4.28m during 2020/21. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement

	31/3/2019 Actual £m	31/3/2020 Forecast £m	31/3/2021 Budget £m	31/3/2022 Budget £m	31/3/2023 Budget £m	31/3/2024 Budget £m
General Fund services	11.6	13.1	17.7	20.9	17.9	14.6
Council housing (HRA)	172.4	172.1	171.8	170.0	168.1	166.4
Capital investments	0	0	0	0	0	0
TOTAL CFR	184.0	185.2	189.5	190.9	186.0	181.0

- 1.10 **Asset management:** The Council's assets require regular maintenance to ensure they remain safe and fit for purpose. It is also important for income generation that assets remain in a good condition and so remain lettable. A planned approach yields savings in running costs and energy efficiency benefits over time as works are completed and asset conditions improve.
- 1.11 **Asset disposals:** When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. Repayments of capital grants, loans and investments also generate capital receipts. The Council plans to receive £4.0m of capital receipts in the coming financial year as follows:

Table 5: Capital receipts

	2018/19 Actual £m	2019/20 Forecast £m	2020/21 Budget £m	2021/22 Budget £m	2022/23 Budget £m	2023/24 Budget £m
Asset sales	5.0	5.0	4.0	4.0	4.0	4.0
Loans repaid	0	0	0	0	0	0
TOTAL	5.0	5.0	4.0	4.0	4.0	4.0

Treasury Management

- 1.12 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.
- 1.13 Due to decisions taken in the past, the Council currently has £149.7m borrowing at an average interest rate of 3.52% and £34.5m treasury investments at an average rate of 0.84%.
- 1.14 **Borrowing strategy:** The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.75%) and long-term fixed rate loans where the future cost is known but higher (currently 2.00%-3.00%).
- 1.15 Projected levels of the Council's total outstanding debt which comprises borrowing, PFI liabilities and leases are shown below, compared with the capital financing requirement:

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

	31/3/2019 Actual £m	31/3/2020 Forecast £m	31/3/2021 Budget £m	31/3/2022 Budget £m	31/3/2023 Budget £m	31/3/2024 Budget £m
Debt	150.8	149.5	149.2	147.0	146.9	144.8
Capital Financing Requirement	184.0	185.2	189.5	190.9	186.0	181.0

- 1.16 Statutory guidance states that debt should remain below the capital financing requirement, except in the short-term. As can be seen from **Table 6**, the Council expects to comply with this in the medium term.
- 1.17 **Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing:

Table 7: Borrowing and the Liability Benchmark

	31/3/2019 Actual £m	31/3/2020 Forecast £m	31/3/2021 Budget £m	31/3/2022 Budget £m	31/3/2023 Budget £m	31/3/2024 Budget £m
Outstanding borrowing	150.8	149.5	149.2	147.0	146.9	144.8
Liability benchmark	140.6	142.0	147.5	147.0	146.9	144.8

1.18 The table above shows that the Council expects to remain borrowed above or at its liability benchmark. This is because cash outflows to date have been below the assumptions made when the loans were borrowed.

1.19 **Affordable borrowing limit:** 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 the limit.

Table 8: Prudential Indicators: Authorised limit and operational boundary for external debt

	2019/20 limit £m	2020/21 limit £m	2021/22 limit £m	2022/23 limit £m	2023/24 limit £m
Authorised limit – borrowing	195.2	199.5	200.9	196.0	191.0
Authorised limit – leases	0	0	0	0	0
Authorised limit – total external debt	195.2	199.5	200.9	196.0	191.0
Operational boundary – borrowing	190.2	194.5	195.9	191.0	186.0
Operational boundary – leases	0	0	0	0	0
Operational boundary – total external debt	190.2	194.5	195.9	191.0	186.0

The authorised limit and operational boundary for 2020/21 and subsequent years include a £0.0m increase due to a change in the accounting for leases.

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

1.21 The Council’s policy on treasury investments is to prioritise security and liquidity over yield, which is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the

risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice.

Table 9: Treasury management investments

	31/3/2019 Actual £m	31/3/2020 Forecast £m	31/3/2021 Budget £m	31/3/2022 Budget £m	31/3/2023 Budget £m	31/3/2024 Budget £m
Near-term investments	20.0	17.5	11.7	10.0	10.0	10.0
Longer-term investments	0	0	0	0	0	0
TOTAL	20.0	17.5	11.7	10.0	10.0	10.0

- 1.22 **Risk management:** 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.
- 1.23 **Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Chief Finance Officer and staff, who must act in line with the treasury management strategy approved by Council. Quarterly reports on treasury management activity are presented to Cabinet. The Audit and Corporate Governance Scrutiny Committee is responsible for scrutinising treasury management decisions.

Investments for Service Purposes

- 1.24 The Council can make investments to assist local public services, including making loans to local service providers and businesses to promote economic growth. In light of the public service objective, the Council is willing to take more risk than with treasury investments, however it still plans for such investments to at least break even after all costs. This includes loans to the Council's ALMO, Rykneld Homes Ltd to allow development of social housing. Rykneld Homes Ltd is a wholly owned subsidiary of the Council, limited by guarantee.
- 1.25 **Governance:** Decisions on service investments are made by the relevant service manager and submitted to Cabinet then Council in consultation with the Chief Finance Officer and must meet the criteria and limits laid down in the Investment Strategy.

Commercial Activities

- 1.26 With central government financial support for local public services declining, the Council has invested in developing residential property through Northwood Group Ltd mainly for financial gain. Currently (at 31/12/19), an investment of £0.992m has been made into Northwood Group Ltd and further future investment of £7.821m is approved to provide a total investment of £8.813m.
- 1.27 With financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. The principal risk exposures include build cost estimates, sales values estimates and demand. These risks are mitigated by working with experienced builders and professionals who have knowledge of the local market. In order that commercial investments remain proportionate to the size of the Council, these are subject to an overall maximum investment limit of £8.813m and contingency plans are in place should expected yields not materialise.
- 1.28 **Governance:** Decisions on commercial investments are made by Council in line with the criteria and limits approved in the Investment Strategy. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.
- 1.29 The Council also has investment properties generating £0.472m in net income a year after all costs.

Liabilities

- 1.30 In addition to debt of £150.8m detailed above, the Council is committed to making future payments to cover its net pension fund deficit (valued at £54.0m). It has also set aside £1.8m to cover risks of business rates appeals.
- 1.31 **Governance:** Decisions on incurring new discretionary liabilities are taken to Council for approval. The risk of liabilities occurring and requiring payment are monitored as part of the year-end process.

Revenue Budget Implications

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

Table 10: Prudential Indicator: Proportion of financing costs to net revenue stream

	2018/19 Actual £m	2019/20 Forecast £m	2020/21 Budget £m	2021/22 Budget £m	2022/23 Budget £m	2023/24 Budget £m
Financing costs	1.0	0.9	0.8	0.7	0.7	0.8
Proportion of net revenue stream	6.70%	7.75%	5.58%	5.15%	5.33%	6.20%

There is no increase to financing costs in 2020/21 and subsequent years resulting from the change in the accounting for leases.

- 1.33 **Sustainability:** Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The Chief Finance Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable.

Knowledge and Skills

- 1.34 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. Suitably qualified and experienced officers are employed throughout the Council to perform such functions.
- 1.35 Where Council officers 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. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.
- 1.36 Members receive individual training and development through the Member Development Programme and are periodically required to attend seminars held by the external treasury management advisors.

Treasury Management Operations

- 1.37 As mentioned above the Council uses external treasury management advisors. The company provides a range of services which include:
- Technical support on treasury matters, capital finance issues and the drafting of Member reports;
 - Economic and interest rate analysis;
 - Debt services which includes advice on the timing of borrowing;
 - Debt rescheduling advice surrounding the existing portfolio;
 - Generic investment advice on interest rates, timing and investment instruments;

- A number of places at training events offered on a regular basis.
- Credit ratings/market information service comprising the three main credit rating agencies;

1.38 Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remains with the Council. This service is subject to regular review. It should be noted that the Council has Arlingclose Ltd as external treasury management advisors, for a period of up to 3 years commencing October 2019.

Banking Contract

1.39 The contract with the Councils banking provider Lloyds Bank commenced on the 10th February 2015 for a period of 7 years.

Business Continuity Arrangements

1.40 As part of the Councils business continuity arrangements officers have sought to set up and provide alternative banking arrangements for the Council should they be required at short notice. These arrangements effectively mean a separate bank account is in place with the required security controls and appropriate officer access to undertake transactions. This account is with Barclays Bank and will only be utilised should a business continuity need or similar issue arise. Officers will continue to review this arrangement.

Appendix A

Capital Programme 2019-2024

Capital Expenditure	Revised Budget 2019/20 £	Original Budget 2020/21 £	Original Budget 2021/22 £	Original Budget 2022/23 £	Original Budget 2023/24 £
Housing Revenue Account					
HRA Capital Works	9,395,000	9,000,000	9,000,000	9,000,000	9,000,000
EWI Scheme - Heath & Pilsley	1,350,000	0	0	0	0
Pine View, Danesmoor	877,000	600,000	0	0	0
North Wingfield New Build Scheme	197,000	0	0	0	0
Stock Purchase Programme (1-4-1)	555,000	0	0	0	0
Acquisitions and Disposals (RHL)	500,000	500,000	500,000	500,000	500,000
Car Park Resurfacing - Holmesfield	40,000	0	0	0	0
Car Park Resurfacing - Pilsley	40,000	0	0	0	0
North Wingfield New Build Project	0	2,015,000	0	0	0
HRA - Capital Expenditure	12,954,000	12,115,000	9,500,000	9,500,000	9,500,000
General Fund					
Private Sector Housing Grants (DFG's)	708,000	393,000	393,000	393,000	393,000
ICT Schemes	169,000	158,000	35,000	160,000	63,000
Clay Cross Football Pitch	11,000	0	0	0	0
Asset Refurbishment - General	577,000	500,000	500,000	500,000	500,000
Roller Shutter Doors	64,000	0	0	0	0
Eckington Pool Roof Replacement	270,000	0	0	0	0
Replacement of Vehicles	1,206,000	2,327,000	2,260,000	175,000	163,000
Contaminated Land	42,000	0	0	0	0
Northwood Grant	660,000	289,500	0	0	0
General Fund Capital Expenditure	3,707,000	3,667,500	3,188,000	1,228,000	1,119,000
Total Capital Expenditure	16,661,000	15,782,500	12,688,000	10,728,000	10,619,000
Capital Financing					
Housing Revenue Account					
Major Repairs Reserve	(9,000,000)	(9,000,000)	(9,000,000)	(9,000,000)	(9,000,000)
Prudential Borrowing - HRA	(1,469,000)	(1,410,000)	0	0	0
Development Reserve	(1,742,000)	(600,000)	0	0	0
Capital Receipts Reserve	(426,500)	(350,000)	(350,000)	(350,000)	(350,000)
1-4-1 Receipts	(316,500)	(755,000)	(150,000)	(150,000)	(150,000)
HRA Capital Financing	(12,954,000)	(12,115,000)	(9,500,000)	(9,500,000)	(9,500,000)
General Fund					
Disabled Facilities Grant	(688,000)	(373,000)	(373,000)	(373,000)	(373,000)
External Grant - Lottery Funded Schemes	(11,000)	0	0	0	0
External Grant - Contaminated Land	(42,000)	0	0	0	0
Prudential Borrowing - Vehicles	(1,206,000)	(2,327,000)	(2,260,000)	(175,000)	(163,000)
Prudential Borrowing - Eckington Pool Roof	(270,000)	0	0	0	0
RCCO - Roller Shutter Doors	(64,000)	0	0	0	0
RCCO - Vehicles	(35,739)	0	0	0	0
Useable Capital Receipts	(730,261)	(678,000)	(555,000)	(680,000)	(583,000)
1-4-1 Receipts	(660,000)	(289,500)	0	0	0
General Fund Capital Financing	(3,707,000)	(3,667,500)	(3,188,000)	(1,228,000)	(1,119,000)
HRA Development Reserve					
Opening Balance	(1,775,719)	(925,522)	(1,193,468)	(2,752,143)	(4,982,043)
Amount due in year	(891,803)	(867,946)	(1,558,675)	(2,229,900)	(2,229,900)
Amount used in year	1,742,000	600,000	0	0	0
Closing Balance	(925,522)	(1,193,468)	(2,752,143)	(4,982,043)	(7,211,943)
Major Repairs Reserve					
Opening Balance	(176,108)	(176,108)	(176,108)	(176,108)	(176,108)
Amount due in year	(9,000,000)	(9,000,000)	(9,000,000)	(9,000,000)	(9,000,000)
Amount used in year	9,000,000	9,000,000	9,000,000	9,000,000	9,000,000
Closing Balance	(176,108)	(176,108)	(176,108)	(176,108)	(176,108)
Capital Receipts Reserve					
Opening Balance	(2,786,312)	(807,811)	(579,811)	(474,811)	(244,811)
Income expected in year	(4,000,000)	(4,000,000)	(4,000,000)	(4,000,000)	(4,000,000)
Allowable Debt/Pooling Expenses	3,200,000	3,200,000	3,200,000	3,200,000	3,200,000
Amount used in year	2,778,500	1,028,000	905,000	1,030,000	933,000
Closing Balance	(807,811)	(579,811)	(474,811)	(244,811)	(111,811)
Capital Receipts Reserve 1-4-1 receipts					
Opening Balance	(2,772,278)	(1,795,778)	(751,278)	(601,278)	(451,278)
Income expected in year	0	0	0	0	0
Amount used in year	976,500	1,044,500	150,000	150,000	150,000
Closing Balance	(1,795,778)	(751,278)	(601,278)	(451,278)	(301,278)
Total Capital Financing	(16,661,000)	(15,782,500)	(12,688,000)	(10,728,000)	(10,619,000)

Appendix B

Annual Minimum Revenue Provision Statement 2020/21

Where the Council finances General Fund 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 Authority to have regard to the Ministry for Housing, Communities and Local Government's *Guidance on Minimum Revenue Provision* (the MHCLG Guidance) most recently issued in 2018.

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.

The MHCLG Guidance requires the Council, to approve an Annual MRP Statement each year, and includes recommendations for calculating a prudent amount of MRP. In line with this guidance the Council has adopted the following:

- For capital expenditure incurred before 1st April 2008 MRP will be determined in accordance with the former regulations. During 2019/20 the Council fully repaid this debt so it is no longer applicable.
- For capital expenditure incurred before 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in equal instalments, starting in the year after the asset becomes operational.

Capital expenditure incurred during 2020/21 will not be subject to a MRP charge until 2021/22 and so on.

Based on the Council's latest estimate of its Capital Financing Requirement on 31st March 2020, the budget for MRP has been set as follows:

	31/03/20 Estimated CFR £m	2020/21 Estimated MRP £m
Supported capital expenditure after 31.03.2008	0	0
Unsupported capital expenditure after 31.03.2008	13.1	1.0
Total General Fund	13.1	1.0
Assets in the Housing Revenue Account	45.0	0
HRA subsidy reform payment	127.1	0
Total Housing Revenue Account	172.1	0
Total	185.2	1.0

Revenue Account (HRA)

Following the budget on 30 October 2018, the legislation that capped the amount of HRA debt a local housing authority could hold was revoked with immediate effect. The capital financing requirements relating to the HRA will remain the same so there will still be no requirement for an MRP and levels of debt will be managed through prudential borrowing limits controlled by the Treasury Management Strategy.

Removing the debt cap and not having a statutory requirement to make a provision to repay debt presents a significant risk to the HRA. Very careful treasury management is needed to ensure that the Council's HRA borrowing remains affordable, prudent and reasonable and that the HRA remains sustainable over the long term. As a result, it is also prudent to consider having a voluntary debt cap and this is currently under review.



North East Derbyshire District Council

Investment Strategy 2020/21 – 2023/24

Introduction

- 1.1 The Council invests its money for three broad purposes:
- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (**treasury management investments**),
 - to support local public services by lending to or buying shares in other organisations (**service investments**), and
 - to earn investment income (**commercial investments**).
- 1.2 This investment strategy meets the requirements of the statutory guidance issued by the government in January 2018, and focuses on the second and third of these categories.

Treasury Management Investments

- 1.3 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. The balance of treasury management investments is expected to fluctuate between £17.0m and £34.5m during the 2020/21 financial year.
- 1.4 **Contribution:** The contribution that these investments make to the objectives of the Council is to support effective treasury management activities.
- 1.5 **Further details:** Full details of the Council's policies and its plan for 2020/21 for treasury management investments are covered in the Treasury Management Strategy.

Service Investments: Loans

- 1.6 **Contribution:** The Council lends money to assist local public services, including making loans to local service providers and businesses to stimulate local economic growth. This includes loans to the Council's ALMO, Rykneld Homes Ltd to allow development of social housing. Rykneld Homes Ltd is a wholly owned subsidiary of the Council, limited by guarantee. It also includes a loan to Northwood Group Ltd for a mixed tenure housing development scheme in the district.
- 1.7 **Security:** The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding loans to each category of borrower have been set as follows:

Table 1: Loans for service purposes

Category of borrower	31/3/2019 actual			2020/21
	Balance owing £m	Loss allowance £m	Net figure in accounts £m	Approved Limit £m
Rykneld Homes Ltd	4.5	0	4.5	13.5
Northwood Group Ltd	0	0	0	7.7
TOTAL	4.5	0	4.5	21.2

- 1.8 Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's statement of accounts are 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.
- 1.9 **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding service loans by requiring a fully costed business case in all instances that includes any investment/loan requirements and financial/risk implications. A significant amount of due diligence work is undertaken in each case to ensure the business case is robust. Regards loans to Rykneld Homes Ltd, the strength of the partnership between the company and the Council helps to mitigate any risk associated with non-payment of the loan.

Service Investments: Shares

- 1.10 **Contribution:** The Council has invested £0.244m to date (up to 31st December 2019) in the shares of Northwood Group Ltd to support local public services and stimulate

local economic growth by delivering housing developments whilst generating income for the Council.

- 1.11 **Security:** One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. In order to limit this risk, upper limits on the sum invested in each category of shares have been set as follows:

Table 2: Shares held for service purposes

Category of company	31/3/2019 actual			2020/21
	Amounts invested £m	Gains or (losses) £m	Value in accounts £m	Approved Limit £m
Northwood Group Ltd	0.150	(0.003)	0.147	1.113
TOTAL	0.150	(0.003)	0.147	1.113

- 1.12 **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding shares by working with experienced professionals who have extensive knowledge of the projects and the local markets. In order that commercial investments remain proportionate to the size of the Council, these are subject to overall maximum investment limits and contingency plans are in place should expected yields not materialise.
- 1.13 **Liquidity:** the viability models for each project the Council considers take account of the maximum periods for which funds may prudently be committed and states what those maximum periods are within approved contracts. This will assist the Council to stay within its stated investment limits.
- 1.14 **Non-specified Investments:** Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in the government guidance. The Council has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

Commercial Investments: Property

- 1.15 MHCLG defines property to be an investment if it is held primarily or partially to generate a profit.
- 1.16 **Contribution:** The Council invests in local, commercial and residential property with the intention of making a profit that will be spent on local public services. This includes the industrial units across the district as well as residential property development through Northwood Group Ltd.

Table 3: Property held for investment purposes

Property	Actual	31/3/2019 actual		31/3/2020 expected	
	Purchase cost	Gains or (losses)	Value in accounts	Gains or (losses)	Value in accounts
Industrial Units	4.4	0.8	5.2	0	5.2
Land	2.2	5.9	8.1	0	8.1
Commercial Properties	1.1	(0.1)	1.0	0	1.0
Shared Ownership Properties	1.1	0.5	1.6	0	1.6
Northwood Group Ltd	0	0	0	0	0
TOTAL	8.8	7.1	15.9	0	15.9

- 1.17 **Security:** In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.
- 1.18 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.
- 1.19 On revaluation the commercial properties decreased by £0.1m as a result of a general fall in market valuations of properties of this nature. This has no material impact on the security of the investment and the revenue implication was £0.1m, accounted for in 2017/18.
- 1.20 **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding property investments by working with experienced professionals who have extensive knowledge of the projects, properties and local markets. In order that commercial investments remain proportionate to the size of the Council, these are subject to overall maximum investment limits and contingency plans are in place should expected yields not materialise.
- 1.21 **Liquidity:** Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. The Council's Treasury Management Strategy provides assurances through limits on long-term investments to ensure that the invested funds or suitable alternatives can be accessed when they are needed, for example to repay capital borrowed.

Loan Commitments and Financial Guarantees

- 1.22 Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness.
- 1.22 The Council has contractually committed to make up to £7.7m of loans to Northwood Group Ltd should it request it. The Council has also guaranteed loans of £13.430m to Rykneld Homes Ltd.

Borrowing in Advance of Need

- 1.23 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.

Capacity, Skills and Culture

- 1.24 **Elected members and statutory officers:** The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. Suitably qualified and experienced officers are employed throughout the Council to perform such functions.
- 1.25 Where Council officers 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. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.
- 1.26 Members receive individual training and development through the Member Development Programme and are periodically required to attend seminars held by the external treasury management advisors.
- 1.27 **Commercial deals:** All Officers involved in negotiating such arrangements are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate and considerable due diligence is undertaken in all instances.
- 1.28 **Corporate governance:** All decisions regards new loans or investments of this nature are considered by the Council's Cabinet before being recommended for approval at Council. Any presentation to members will have been through a fully costed business case that includes any investment/loan requirements and financial/risk implications. A significant amount of due diligence work is undertaken in each case to ensure the business case is robust before reporting to Cabinet.

Investment Indicators

- 1.29 The Council has set the following quantitative indicators to assess the total risk exposure as a result of its investment decisions.
- 1.30 **Total risk exposure:** The first indicator shows the Council's total exposure to potential investment losses. This includes amounts the Council is contractually committed to lend but have yet to be drawn down and guarantees the Council has issued over third party loans.

Table 5: Total investment exposure

Total investment exposure	31/03/2019 Actual £m	31/03/2020 Forecast £m	31/03/2021 Forecast £m
Treasury management investments	20.00	17.50	11.70
Service investments: Loans – Rykneld Homes Ltd	4.66	7.17	13.43
Service investments: Loans – Northwood Group Ltd	0	1.00	7.70
Service investments: Shares – Northwood Group Ltd	0.15	0.24	1.11
Commercial investments: Property	15.90	15.90	15.90
TOTAL INVESTMENTS	40.71	41.81	48.84
Commitments to lend	0	13.83	0
TOTAL EXPOSURE	40.71	55.64	48.84

- 1.31 **How investments are funded:** Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. To date these investments have been funded by usable reserves and income received in advance of expenditure. It is planned that this approach will continue in the medium term as internal resources allow.
- 1.32 **Rate of return received:** This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Table 6: Investment rate of return (net of all costs)

Investments net rate of return	2018/19 Actual £m	2019/20 Forecast £m	2020/21 Forecast £m
Treasury management investments	0.70%	0.46%	0.29%
Service investments: Loans – Rykneld Homes Ltd	3.96%	3.51%	2.78%
Service investments: Loans – Northwood Group Ltd	0.00%	5.09%	5.09%
Service investments: Shares – Northwood Group Ltd	0.00%	0.00%	0.00%
Commercial investments: Property	2.96%	2.81%	2.68%

- 1.33 The indicators used to report on the risks and opportunities associated with investment decisions will be kept under review as the Council's Investment Strategy and activities evolve over time.