
Revision of the agreed 2019/20 Investment and Borrowing Strategy

1. Introduction/Background

- 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 Authority to approve a treasury management strategy before the start of each financial year. The 2019/20 Investment and Borrowing Strategy was approved by Full Council at the meeting held on 5 March 2019 meetings its legal obligation under the Local Government Act 2003. This report is an amendment of the agreed strategy to reflect:
- (1) Outline compliance against the Prudential Indicators
 - (2) An expansion in the sources of borrowing available to the Council
 - (3) Allow for provision of loan financing to local enterprises, charities, wholly owned companies and joint ventures as part of a wider strategy for local economic growth. In particular the joint venture in the form of Limited Liability Partnership (LLP) with Sovereign Westing House Developments Ltd, a subsidiary of Sovereign Housing Association (SHA).
- 1.3 The Council has approved a revised Property Investment Strategy in July 2018. The criteria for investment in property, are different from those for cash based investments. However the strategy for borrowing set out in this document also applies to borrowing to fund investment in property.

2. Local Context and Prudential Indicators

- 2.1 The Prudential Code requires authorities to look at capital and investment plans in light of overall organisation strategy and resources to ensure that decisions are made with sufficient regard to the long term financing implications and risks to the Council. To demonstrate that local authorities have fulfilled these objectives, the code sets out a number of indicators, the code does not include suggested indicative limits or ratios. Local Authorities are to set their own limits and ratios, subject to controls under section 4 of the Local Government Act 2003.
- 2.2 As at 31 March 2019, the Authority held total borrowing of £222.6million of borrowing (including £200.4million PWLB loans, £8.5million short term loans which

were all repaid in April 2019 and £14.9million debt embedded in the Waste PFI contract. The authority also held £26m of fixed term investments at that date.

2.3 The main aim of the Treasury Management function is to maximise the return on the Council’s investments while ensuring sufficient liquidity and minimising the risks to the Council’s resources. All investment and borrowing decisions are therefore governed by the following principles (in order of priority as shown):

- (1) Security (minimising risk)
- (2) Liquidity (availability of sufficient funds a day to day basis to support the Council’s business)
- (3) Yield (return on investment).

2.4 The Council’s capital programme is a key driver of the treasury management activity. The output of the capital programme is reflected in the prudential indicators.

2.5 The CIPFA Prudential Indicators

Indicator One: Estimates of Capital Expenditure

The indicator is a summary of the Council’s estimated capital expenditure for the current Capital Strategy (2019/20 – 2022/23) including funding from external sources (grants and contributions) and capital receipts, the balance remaining being the net financing requirement.

	Forecast 2019/20 £000s	Approved 2020/21 Capital Programme £000s	Approved 2021/22 Capital Programme £000s
People Directorate	17,709	14,109	11,337
Place Directorate	17,856	16,089	9,829
Resources Directorate	3,707	2,815	2,368
Invest to Save Schemes	750	-	-
Commercial Activities	37,747	-	-
Total Requirement	77,769	33,013	23,534
Financed By:			
Capital Receipts	241	1,320	-
Capital Grants & Contributions (inc s106 and CIL)	26,253	22,372	14,107
Net Financing Requirement	51,275	9,321	9,427

Note: Invest to save schemes are included in total capital expenditure and funding resources, however, these schemes will generate income and/or savings in revenue budgets elsewhere in the Council’s services. Therefore the borrowing costs associated with invest to save schemes have minimal impact on the Council’s Medium Term Financial Strategy position.

Indicator Two: Estimates of the Capital Financing Requirement (CFR)

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.

The CFR is the total historical capital expenditure which has not yet been paid for from either revenue or capital resources. It is a measure of the Council's underlying borrowing requirement. Any capital expenditure which has not immediately been paid for will increase the CFR. The CFR does not increase indefinitely, as the Minimum Revenue Provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used. The CFR includes any other long-term liabilities (e.g. PFI schemes, finance leases) included on the Council's balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of schemes include a borrowing facility and so the Council is not required to separately borrow for these.

Capital Financing Requirement (CFR)	Forecast 2019/20 £000s	As per Approved 2020/21 Capital Programme £000s	As per Approved 2021/22 Capital Programm £000s
CFR brought forward at 31.3	240,120	284,293	286,243
Borrowing to fund Operational Assets	12,778	9,321	9,427
Invest to Save	750	-	-
Commercial Activities	37,747	-	-
Lease Liabilities	-	-	-
Increase in borrowing to fund capital expenditure	51,275	9,321	9,427
Less MRP & other financing	7,102	7,371	7,682
CFR carried forward at yr end	284,293	286,243	287,988
Movement in CFR	44,173	1,950	1,745

Indicator Three: Ratio of Net Financing Costs

The Council is required to disclose the actual and estimates of the ratio of financing costs to net revenue budget, i.e. the proportion of the revenue budget funding the financing of capital expenditure (net interest and the minimum provision to repay debt). The table below shows the actual and estimated ratios for the duration of the current Capital Strategy (2019/20 – 2022/23)

	Forecast 2019/20 %	As per Approved 2020/21 Capital Programme %	As per Approved 2021/22 Capital Programme %
Total Ratio	10.0%	10.1%	10.2%

Indicator Four: Actual External Borrowing

The Council needs to ensure that its total borrowing does not, except in the short-term, exceed the total of the CFR in 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. The table below details the Council's forecast treasury position at 31st March 2020, with estimates for future years (actual external borrowing (gross debt) against the CFR).

	Forecast 2019/20 £000s	As per Approved 2020/21 Capital Programme £000s	As per Approved 2021/22 Capital Programm £000s
Long term loans to fund Operational Assets	125,623	128,139	129,572
PWLB Maturity Loans inherited from Berkshire County Council	20,500	20,500	20,500
Long term loans to fund property investment	100,000	100,000	100,000
Other long term liabilities	12,971	12,249	11,843
Gross Debt at 31st March	259,094	260,888	261,915
CFR	284,293	286,243	287,988
Percentage of Gross Debt to CFR	91%	91%	91%

Indicator Five: The Operational Boundary.

The Council is required to determine the limit for total external debt, i.e. the most money the Council would normally borrow at any time during the year. Table five below sets out the limits for external debts for 2019/20 and future years as agreed by Full Council on 5 March 2019.

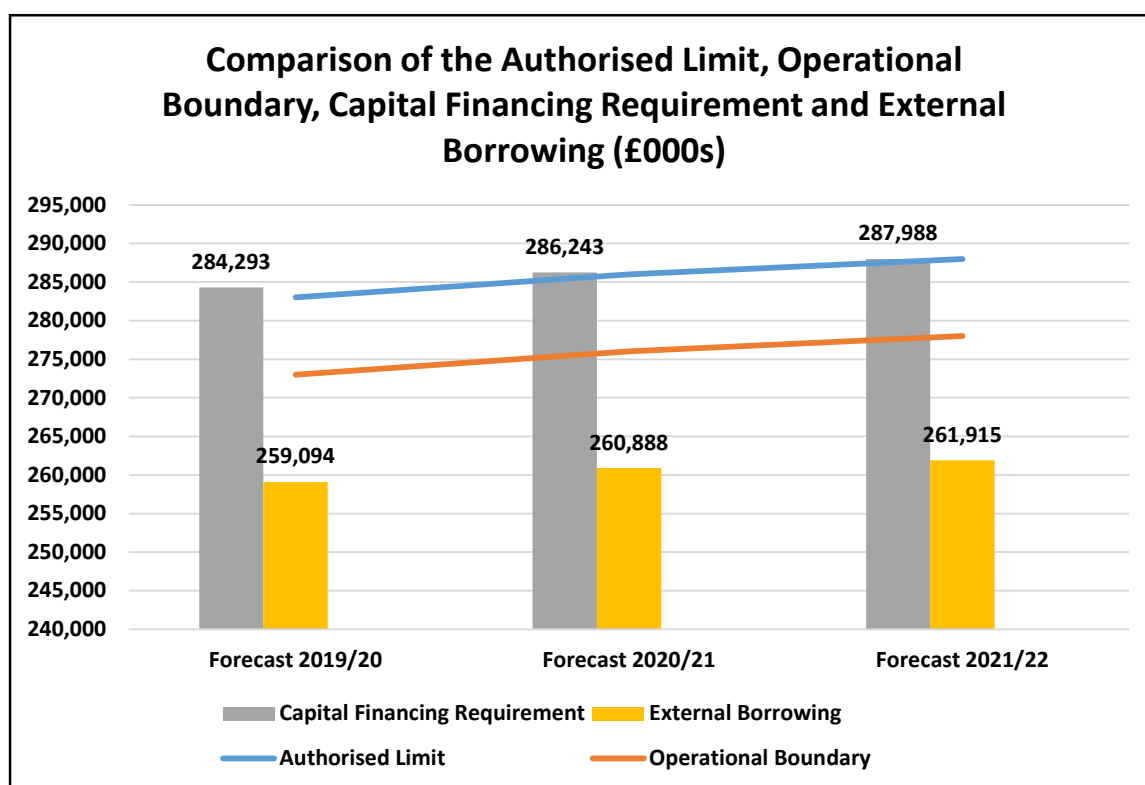
	As per Approved 2019/20 Capital Programme £000s	As per Approved 2020/21 Capital Programme £000s	As per Approved 2021/22 Capital Programm £000s
Borrowing	245,029	248,751	251,157
Other long term liabilities	12,971	12,249	11,843
Other temporary borrowing	15,000	15,000	15,000
Total	273,000	276,000	278,000

Indicator Six: The Authorised Limit.

The Council is required to determine the limit for External Borrowing which refers to the maximum amount the Council is able to borrow. Table three below sets out the limits for external debts for 2019/20 and future years as agreed by Full Council on 5 March 2019. This is a statutory limit determined under section 3 (1) of the Local Government Act 2003. Government under sections 4(1) and 4(2) may limit either the total of all Council borrowing, or those of a specific Council.

	As per Approved 2019/20 Capital Programme £000s	As per Approved 2020/21 Capital Programme £000s	As per Approved 2021/22 Capital Programm £000s
Borrowing	255,029	258,751	261,157
Other long term liabilities	12,971	12,249	11,843
Other temporary borrowing	15,000	15,000	15,000
Total	283,000	286,000.0	288,000

- 2.6 The operational boundary and authorised limit were increased by an additional £50m in 2017/18 and then by a further £50 million in July 2018 to allow for borrowing for investment in commercial property, in line with the approved Property Investment Strategy.
- 2.7 Due to the re-profiling of some capital spend, the total amount borrowed in 2018/19 was lower than expected at the time of setting the 2018/19 limits. For this reason it was not necessary to increase the borrowing limits for 2019/20 at the time of approving the Investment and Borrowing Strategy. However, it was proposed and agreed to increase the borrowing limits for 2020/21 by £3 million, and by a further £2 million in 2021/22.
- 2.8 The graph below provides a comparison of the authorised limit, operational boundary, CFR and the actual anticipated external borrowing level.



3. The Borrowing Strategy

- 3.1 As at 31 March 2019, the Council held £200.4million PWLB of loans, an increase of £40.7million on the prior year, as part of its strategy for funding the capital programme. The forecast included in the table under prudential indicator two (CFR) shows that the Council expects to borrow up to £51.5million in 2019/20. The Council may borrow additional funds to pre-fund future years' requirements, providing this does not mean that total borrowing exceeds the authorised limit for borrowing of £283million.
- 3.2 **Objectives:** The Councils' 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.

- 3.3 **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.

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 / 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. Alternatively, the Authority may arrange forward starting loans during 2019/20, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period. In addition, the Authority may borrow short-term loans to cover unplanned cash flow shortages.

- 3.4 **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 the Royal Berkshire Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.

- 3.5 **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

- 3.6 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, which may be available at more favourable rates:

- (1) **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. Any decision to borrow from the Agency will be the subject of a separate report to Full Council.
- (2) **LOBOs:** The Council does not currently hold any of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which

the Council has the option to either accept the new rate or to repay the loan at no additional cost.

- 3.7 **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 detailed later in Appendix E.
- 3.8 **Debt rescheduling:** The PWLB allows Councils 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.

4. The Investment Strategy

- 4.1 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. During the financial year 2018/19, the Authority's investment fund balance ranged between £20.2million and £57.7million, with an average fund balance of £37.9million. A similar level of fund balance is expected to be maintained in 2019/20.
- 4.2 **Objectives:** The CIPFA Code requires the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.
- 4.3 **Strategy:** The Council recognises the increasing risk and low returns from short-term unsecured bank investments, however, the period for which funds are invested is determined by the cash flow needs of the Council. Funds are invested for as long as possible, in order to maximise the rate of return, while still ensuring that sufficient funds are available to meet the Council's outgoings. The normal maximum period for which funds may prudently be committed is 12 months. If sufficient funds become available, and market conditions are favourable enough to permit secure longer term investment, funds may, from time to time be invested for longer periods which will offer a better rate of return. However in order to minimise risk and ensure liquidity, no more than 40% of the Council's funds will be held at any one time in investments longer than 12 months.
- 4.4 **Business models:** Under 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.
- 4.5 **Specified Investments:** Specified investments are defined as those satisfying each of the following conditions:
- Denominated in sterling.

- To be repaid or redeemed within 12 months of the date on which the investment is made.
- Do not involve the acquisition of share capital or loan capital in any body corporate.
- Are made with the UK government, local authorities, parish councils, community councils, or a deposit taker awarded a high credit rating and authorised by a regulatory body (Financial Services Authority usually).

4.6 **Non Specified Investments:** Any investments that do not meet the criteria set out in 4.1 above are classified as Non-specific investments.

4.7 **Credit ratings and limits:** The credit ratings and limits agreed by Council on 5 March 2019 as detailed in the table below.

Organisations	Maximum Value £000s
Debt Management Office (UK Govt)	Unlimited
UK Local Authorities (including Police and Fire Authorities and similar public bodies)	5,000
UK Building Societies ranked 1 - 11	5,000
UK Building Societies ranked 12-21	4,000
UK Building Societies ranked 22 -25	3,000
UK Banks and other financial institutions rated Prime 1 by Moody's	5,000
UK Banks and other financial institutions rated Prime 2 by Moody's	4,000
UK Banks and other financial institutions rated Prime 3 by Moody's	3,000
UK based money market funds rated AAA by Moody's (per individual fund)	5,000

The Council under section 15(1) of the Local Government Act 2003 can choose to make loans to local enterprises, local charities, wholly owned companies and joint ventures as part of a wider strategy for local economic growth. The Council can make such loans if it can be demonstrated that:

- Total financial exposure of loan is proportionate.
- Have used an allowed “expected credit loss” model for loan and receivables as set out in IFRS 9 Financial Instruments.
- Have appropriate credit control arrangements to recover overdue repayments.
- The Council has formally agreed the total level of loans by type that it is willing to make and the total loan book is within the self-assessed limit (i.e. authorised borrowing limit).

It is proposed under the parameters of paragraph 4.4 above that the table of credit ratings and limits agreed by Full Council is modified to include the following:

Organisations	Maximum Value £000s
Registered Charities, public sector bodies and Council owned companies / joint ventures	5,000

It is not proposed that lending to voluntary groups and parishes will be undertaken.

4.8 **Exposure to Risk:** The proposed investment limits represent the maximum values to be invested with individual organisations. The Treasury Management Group may

temporarily reduce these amounts and or shorten the time period of investments in order to spread the exposure to loss from institutions failing. The Council manages its exposure to risk via a series of treasury management indicators. Appendix E provides greater detail on the indicators used to monitor and review the performance of the treasury management function.

5. Other Options Considered

- 5.1 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The current strategy represents an appropriate balance between risk management and cost effectiveness. However, it is proposed for future financial years that special treasury management advice and support is commissioned from external specialists to ensure the Council remains compliant with the latest legislative amendments, maximises opportunities for generation of yields from investments whilst maintaining a prudent strategy that operates within the Council's risk appetite.

6. Proposals

- 6.1 There are three proposals relating to this strategy:
- (1) Adoption of the revised Investment and Borrowing Strategy for 2019/20.
 - (2) It is proposed that the table of credit ratings and limits agreed by Full Council is modified to include allowance of investing/providing loan finance to registered charities, Council owned companies and joint ventures for a maximum of £5 million per individual investment.
 - (3) For future financial years that special treasury management advice and support is commissioned from external specialists to ensure the Council remains compliant with the latest legislative amendments, maximises opportunities for generation of yields from investments whilst maintaining a prudent strategy that operates within the Council's risk appetite.

7. Conclusion

- 7.1 The strategy sets out the underlying principles by which the Council's annual investment and borrowing activity will be managed for 2019/20. Implementation of the strategy is overseen by the cross party Treasury Management Group. Treasury performance reporting to Executive is undertaken annually at outturn.

8. Consultation and Engagement

- 8.1 Andy Walker – Head of Finance & Property,
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Appendix D

Investments and Borrowing Held at 31 March 2019

Borrowing & Investments	Actual	Average
	31.3.19	Rate
	£000s	%
Public Works and Loans Board (PWLB) Loans to fund Operational Assets	117,680	2.9
PWLB Maturity Loans inherited from Berkshire County Council	20,505	5.8
PWLB Maturity Loans to fund property investment	62,253	2.5
Local Authorities	8,500	0.9
Total external borrowing	208,938	
Other long term liabilities:		
Private Finance Initiative (Waste)	13,651	6.1
Total other long term liabilities	13,651	
Total gross external debt	222,589	
Treasury Investments:		
Fixed Term investments with building societies	26,000	1.1
Deposits in Instant Access bank accounts and money market funds	5,068	0.7
Total treasury investments	31,068	
Net debt	191,521	

Treasury Management Indicators

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:

	2019/20 Forecast £000s	2020/21 Estimate £000s	2021/22 Estimate £000s
Impact of a 1% rise in interest rates:			
Long term borrowing	-	416	471
Other Long term Liabilities	-	-	-
Short term borrowing	13	13	13
Investments	- 26	- 260	- 260
Total Impact of a 1% rise in interest rates:	- 13	169	224
Impact of a 1% fall in interest rates			
Long term borrowing	-	- 414	- 467
Other Long term Liabilities	-	-	-
Short term borrowing	- 13	- 13	- 13
Investments	26	260	260
Total Impact of a 1% rise in interest rates:	13	- 167	- 220

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

Maturity structure of borrowing:

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

Refinancing rate risk indicator	Upper Limit	Lower Limit
Under 12months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and above	50%	0%

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