TORBAY COUNCIL

Treasury Management Strategy 2021/22

November 2020

Contents

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1 Introduction

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.

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 full 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.

The Strategy for 2021/22 covers:

- Capital expenditure and prudential indicators
- the minimum revenue provision (MRP) policy
- prospects for interest rates;
- the borrowing strategy;
- the investment strategy;
- treasury indicators which limit the treasury risk and activities of the Council
- policy on use of external service providers;
- reporting arrangements and management evaluation
- other matters

2 Capital Expenditure and Prudential Indicators

The Council's capital expenditure plans are a key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators below, which are designed to assist Members' overview and confirm capital expenditure plans.

Capital Expenditure and Financing

Capital expenditure is where the Council spends money on assets, such as property or vehicles, which will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets.

In 2021/22, the Council is planning capital expenditure of £104.5m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £ millions

£M	2019/20 actual	2020/21 forecast	2021/22 budget	2022/23 budget	2023/24 budget
General Fund services	38.3	60.3	104.5	93.3	21.9
Capital investments	76.5	0.0	0.0	68.8	0.0
TOTAL	**114.8**	**60.3**	**104.5**	**162.1**	**21.9**

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, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £ millions

£m	2019/20 actual	2020/21 forecast	2021/22 budget	2022/23 budget	2023/24 budget
External sources	13.1	20.5	10.4	15.6	11.9
Own resources	2.7	3.9	1.3	4.6	0.0
Debt	98.9	35.9	92.8	141.9	10.0
TOTAL	**114.8**	**60.3**	**104.5**	**162.1**	**21.9**

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: Replacement of debt finance in £ millions

	2019/20 actual	**2020/21 forecast**	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**
MRP	5.3	7.2	7.6	8.4	n/a

The Council's full policy on Minimum Revenue Provision is statement is available at Appendix 2

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

Table 4: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2020/21 limit	**2021/22 limit**	**2022/23 limit**	**2023/24 limit**
Authorised limit – borrowing	690	700	700	700
Authorised limit – PFI and leases	20	20	20	20
Authorised limit – total external debt	710	720	720	720
Operational boundary – borrowing	570	590	650	660
Operational boundary – PFI and leases	20	20	20	20
Operational boundary – total external debt	590	610	670	680

Revenue Budget Implications

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 5: Prudential Indicator: Proportion of financing costs to net revenue stream

	2019/20 actual	**2020/21 forecast**	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**
Net Revenue Stream	£111m	£116m	£113m	£113m	£113m
Financing costs (£m)	£15m	£20m	£19m	£19m	£19m
Proportion of net revenue stream	**13%**	**17%**	**17%**	**17%**	**17%**
Financing costs excludes income from Investment Property portfolio which is included within the Net Revenue Stream. *Gross Rental Income (as at Sept 20)*	£(10)m	£(15)m	£(13)m	£(13)m	£(13)m
Percentage of Financing Costs to Net Revenue Stream including Investment Property Gross Rental Income	4%	5%	6%	6%	6%

3 Local Context

On 30th September 2020, the Council held £391.8m of borrowing and £78.8m of treasury investments. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 6: Balance sheet summary and forecast

	31.3.20 Actual £m	31.3.21 Estimate £m	31.3.22 Forecast £m	31.3.23 Forecast £m	31.3.24 Forecast £m
Total CFR	**413.4**	**441.2**	**521.3**	**654.7**	**653.6**
Less: Other debt liabilities *	(17.5)	(16.8)	(16.1)	(15.4)	(14.7)
Loans CFR	**395.9**	**424.4**	**505.2**	**639.3**	**638.9**
Less: External borrowing **	395.2	391.5	388.9	385.3	377.7
Internal borrowing	**0.7**	**32.9**	**116.3**	**254.0**	**261.2**
Less: Usable reserves	(48.0)	(22.8)	(17.3)	(15.1)	(15.3)
Less: Working capital	(18.9)	(10.0)	(10.0)	(10.0)	(10.0)
(Treasury investments)/New borrowing	**(66.2)**	**0.1**	**89.0**	**228.9**	**235.9**

* PFI liabilities that form part of the Council's total debt

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

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 apply its cash resources in place of external borrowing in the short term, i.e. internal borrowing.

The Council has an increasing CFR due to the capital programme, but limited investments and will therefore be required to borrow up to £235.9m over the forecast period.

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 2021/22.

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 £15m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 7: Liability benchmark

	31.3.20 Actual £m	**31.3.21 Estimate £m**	**31.3.22 Forecast £m**	**31.3.23 Forecast £m**	**31.3.24 Forecast £m**
Loans CFR	**395.9**	**424.4**	**505.2**	**639.3**	**638.9**
Less: Usable reserves	(48.0)	(22.8)	(17.3)	(15.1)	(15.3)
Less: Working capital	(18.9)	(10.0)	(10.0)	(10.0)	(10.0)
Plus: Minimum liquid investments	10.0	15.0	15.0	15.0	15.0
Liability Benchmark	**339.0**	**406.6**	**492.9**	**629.2**	**628.6**

4 Economic and Interest Rate Forecast

The Council's advisors, Arlingclose has provided an economic commentary together with their interest rate forecasts for future years:

Underlying assumptions:

- The medium-term global economic outlook remains weak. Second waves of Covid cases have prompted more restrictive measures and further lockdowns in Europe and the UK. This ebb and flow of restrictions on normal activity will continue for the foreseeable future, at least until an effective vaccine is produced and importantly, distributed.
- The global central bank and government responses have been significant and are in many cases on-going, maintaining more stable financial, economic and social conditions than otherwise.
- Although these measures supported a sizeable economic recovery in Q3, the imposition of a second national lockdown in England during November will set growth back and likely lead to a fall in GDP in Q4.
- Signs of a slowing economic recovery were already evident in UK monthly GDP and PMI data, even before the latest restrictions. Despite some extension to fiscal support measures, unemployment is expected to rise when these eventually come to an end in mid-2021.
- This situation will result in central banks maintaining low interest rates for the medium term. In the UK, Brexit is a further complication. Bank Rate is therefore likely to remain at low levels for a very long time, with a distinct possibility of being cut to zero. Money markets continue to price in a chance of negative Bank Rate.
- Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, the development of a vaccine or if the UK leaves the EU without a deal.

Arlingclose's view of interest rates is set out in table 8 below:

Table 8: Arlingclose interest rates forecast

	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	-0.10	-0.20	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
3-month money market rate													
Upside risk	0.05	0.05	0.05	0.10	0.10	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Downside risk	-0.40	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
5yr gilt yield													
Upside risk	0.40	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70
Arlingclose Central Case	0.00	0.00	0.05	0.10	0.15	0.15	0.20	0.20	0.25	0.25	0.25	0.25	0.25
Downside risk	-0.30	-0.40	-0.50	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60
10yr gilt yield													
Upside risk	0.40	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70
Arlingclose Central Case	0.30	0.30	0.35	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.55	0.55	0.55
Downside risk	-0.30	-0.40	-0.50	-0.55	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
20yr gilt yield													
Upside risk	0.40	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70
Arlingclose Central Case	0.70	0.70	0.70	0.75	0.75	0.75	0.80	0.80	0.85	0.85	0.85	0.85	0.85
Downside risk	-0.20	-0.20	-0.25	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30
50yr gilt yield													
Upside risk	0.40	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70
Arlingclose Central Case	0.60	0.60	0.60	0.65	0.65	0.65	0.70	0.70	0.75	0.75	0.75	0.75	0.75
Downside risk	-0.20	-0.20	-0.25	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30

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

- Arlingclose expects Bank Rate to remain at the current 0.10% level.
- Additional monetary loosening through increased financial asset purchases was delivered as expected. The central case for Bank Rate is no change, but further cuts to zero, or perhaps even into negative territory, cannot be completely ruled out.
- Gilt yields will remain very low in the medium term. Shorter term gilt yields are currently negative and will remain around zero or below until either the Bank expressly rules out negative Bank Rate or growth/inflation prospects improve.

Downside risks remain in the near term, as the government continues to react to escalation in infection rates and the Brexit transition period comes to an end.

5 Borrowing Strategy

The Council currently holds £391.8million of loans, a decrease of £3.4 million 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 expects to borrow up to £90.8million in 2021/22. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £720 million.

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.

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 investment income rates currently close to zero, it is likely to be most cost effective in the short-term to use internal cash resources instead.

By doing so, the Council is able to reduce net borrowing costs 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.

For external borrowing requirements over and above internal borrowing capacity, the Council will look to the Public Works Loan Board (PWLB) to secure long term funding of projects. (The Council has previously raised the majority of its long-term borrowing from the PWLB). This approach may also be combined with short term borrowing to augment the affordability criteria

The budget for payment of interest on debt for 2021/22 has been based on an assumed £391m of borrowing as at 31/03/21 with an overall borrowing rate of 2.99% (3.03% in 2020/21).

The capital budget for investment property in 21/22 could be removed depending on the outcome of the HM Treasury consultation on use of PWLB.

The borrowing strategy will be highly influenced about clarity around the value and timing of capital projects expected to be funded from borrowing, in particular around housing and regeneration activity.

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 Peninsula Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

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

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.

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 in section 7 Treasury Management Indicators.

Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Chief Finance Officer 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.

6 Investment Strategy

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Currently the Council's investment balance is around £78 million, artificially boosted by emergency Covid-19 funding. As such levels are expected to be substantially lower in the forthcoming year.

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. 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. Whilst this is the aim, in the current climate this may not be achievable and longer term investments will provide protection against the impact of negative rates, discussed below.

Negative interest rates: The potential is increasing for the Bank of England to set its Bank Rate at or below zero, which could 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.

Strategy: The Council believes that the current ultra-low level of returns is insufficient reward for the risk of locking into longer deposits. The bulk of cash balances will therefore continue to be held in short-term liquid deposits and it is accepted that there will likely be zero returns from these investments. Cash levels will be run down by applying to capital funding as per the borrowing strategy in section 5 thereby reducing the cost of external borrowing. Obtaining any yield on 2021/22 investments will rely on existing fixed term deposits and the Council's strategic investment in the CCLA Local Authorities Property Fund.

In the event of cash levels remaining significantly high (e.g. from changes or slippage to the capital plan) the CFO will evaluate options for further diversifying into strategic investments over a longer term to gain yield, subject to appropriate risk management and an overall limit of £15million (representing the minimum forecast level of future Reserves).

The policy for counterparty selection and investment limits is presented at Appendix 3.

Non-Financial Investments Strategy

The MHCLG and CIPFA have extended the meaning of ‘investments’ to include both financial and non-financial investments.

The previous sections relate solely to treasury management “cash” investments and the current schedule of non-financial investments is detailed at Appendix 4. All decisions have followed appropriate risk management framework and strategy for non-financial investments approved by Council in February 2019.

Any involvement by the Council in community investment schemes such as Credit Unions and Mutual Banks would fall into this category and would not be managed within the treasury management policies.

7 Treasury Management Indicators

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

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating/credit score of its investment portfolio. The credit score is calculated by applying a value to each investment (AAA=1, AA+=2, …. A=6 etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator	Target
Portfolio average credit rating (score)	A (6)

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

Liquidity risk indicator	Target
Total cash available within 1 months	£15m

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
Upper limit on one-year revenue impact of a 1% rise in interest rates	£300,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£300,000

The above limits recognise the majority of current borrowing as fixed (no effect of a 1% change) and a net impact with a change on investments. In the current climate a 1% rate reduction will result in negative returns on investments.

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 12 months	40%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	40%	0%
10 years and within 20 years	50%	0%
20 years and within 30 years	60%	0%
30 years and within 40 years	50%	0%
40 years and above	50%	0%

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

Price risk indicator	2020/21	2021/22	2022/23
Limit on principal invested beyond year end	£25m	£20m	£20m

8 Treasury Management Consultants

Arlingclose Ltd was appointed as the Council's external treasury management advisors for three years from April 2020, following a full tender process.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regard to all available information including, but not solely, our treasury advisers.

9 Reporting Arrangements and Management Evaluation

Members will receive the following reports for 2021/22 as standard in line with the requirements of the Code of Practice:

- Annual Treasury Management Strategy
- Mid-Year Treasury Review report
- Annual Treasury Outturn report

The Chief Finance Officer will inform the Cabinet Member for Finance of any long-term borrowing or repayment undertaken or any significant events that may affect the Council's treasury management activities. The CFO will maintain a list of staff authorised to undertake treasury management transactions on behalf of the Council.

The Chief Finance Officer is authorised to approve any movement between borrowing and other long-term liabilities within the Authorised Limit (see Section 2). Any such change will be reported to the next meeting of the Council.

The impact of these policies will be reflected as part of the Council's revenue budget and therefore will be reported through the quarterly budget monitoring process.

The Council's management and evaluation arrangements for Treasury Management will be as follows:

- Monthly monitoring report to the Chief Finance Officer and lead Members.
- Quarterly meeting of the Treasury Manager/ Finance Manager / Chief Finance Officer to review previous quarter performance and plan following period activities
- Regular meetings with the Council's treasury advisors
- Investment benchmarking via Arlingclose Ltd
- The Audit Committee is the body responsible for scrutiny of Treasury Management.

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny and appropriate training was made available to Audit Committee members in June 2019. Further training is intended for Members during 2021/22.

The training needs of treasury management officers are periodically reviewed.

10 Other Matters

Soft Loans

Accounting for financial instruments require the recognition of soft loans i.e. where a loan is made at a lower than ‘competitive’ rate the cost implicit in achieving the lower rate must be reflected in the Council’s accounts.

Anti-Money Laundering

The Council will comply with all relevant regulations.

IFRS 16 Lease Accounting

The Head of Finance will monitor any implications of the introduction of IRFS16 on leases. Now expected to be implemented from April 2021.

Appendix 1

Policy on Minimum Revenue Provision for 2021/22

The Minimum Revenue Provision is a statutory charge that the Council is required to make from its revenue budget. This provision enables the Council to generate cash resources for the repayment of borrowing.

The basis for the calculation of the provision is prescribed by legislation (Local Authorities (Capital Finance and Accounting (England) (Amendment) Regulations 2012 and supported by statutory guidance (last issued March 2018), which states that Councils are required to "determine for the current financial year an amount of MRP that it considers to be prudent" and prepare an annual statement on their MRP calculation to their full Council.

One of the aims of this legislation is to ensure that the repayment of principal owed for Capital expenditure is charged on a prudent basis. Central Government guidance says:

> "*the broad aim of prudent provision is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the Capital expenditure provides benefits"*

For Supported Borrowing, (borrowing funded by central government), the Council will charge MRP at 2% of the balance as at 31 March after the deduction of the value of adjustment A (a set value in 2004), fixed at the same cash value as that of the whole debt is repaid after 50 years.

The Council will charge a VRP (voluntary revenue provision) for the supported borrowing within the adjustment A value that is outstanding as at 31 March relating to transferred debt from Devon County Council fixed at the same cash value as that of the whole debt is repaid after 50 years (which is similar to the supported borrowing calculation).

For capital expenditure funded from unsupported borrowing the Council will make a MRP based on the cumulative expenditure incurred on each asset (including investment fund properties) in the previous financial years using a prudent asset life, which reflects the estimated usable life of that asset. (See table on the following page.)

The MRP for each asset will be calculated on the asset life method using an annuity calculation. MRP will be calculated, on the total expenditure on that asset, in the financial year after the asset becomes operational or 12 months after operational or when there is an income stream in relation to that asset.

The Council will continue to charge services for their use of unsupported borrowing using a prudent asset life (or a shorter period) on an annuity calculation. Where possible the same asset life and borrowing interest rate will be used for both the charge to services and the calculation of the MRP.

To mitigate any negative impact from the changes in accounting for leases and PFI schemes the Council will include in the annual MRP charge an amount equal to the amount that has been taken to the balance sheet to reduce the balance sheet liability for a PFI scheme or a finance lease. The calculation will be based on the annuity method using the Internal Rate of Return (IRR) implicit in the PFI or lease agreement.

Where loans are given for capital purposes they come within the scope of the prudential controls established by the Local Government Act 2003 and the Local Authorities (Finance and Accounting) (England) Regulations 2008.

The Capital Financing Requirement (CFR) will increase by the amount of the loan. Once the funds are returned to the local authority, the returned funds are classed as a capital receipt with those receipts being earmarked specifically to that loan, and the CFR and loan will reduce accordingly. If the expectation is that funds will be repaid in full at some point in the future, there is no requirement to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. The position of each loan will be reviewed on an annual basis by Chief Finance Officer.

Where expenditure is on an investment fund property a MRP may not be applied where there is a clear decision or realistic expectation that an asset purchased as an investment property will be sold within twelve months where the capital receipts from that sale will be set aside to enable repayment of the borrowing associated with the asset.

Where relevant, the suggested asset lives for certain types of capitalised expenditure as detailed in the MRP statutory guidance issued by DCLG will be used. The latest guidance issued in March 2018 suggests a maximum asset life of 50 years.

Each asset life will be considered in relation to the asset being constructed; however as a guide the following are typical ranges for asset lives that will be used.

Asset Type	Range of Asset Life
Freehold Land (speciifed in DCLG statutory gudiance)	50 years
Buildings	20-40 years
Investment Properties	25-50 years
Software	5-10 years
Vehicles & Equipment	5-8 years
Highway Network	25-40 years
Structural Enhancements	10-25 years
Infrastructure	25-50 years

For capital expenditure where land and buildings are not separately identified a blended asset life can be used.

Appendix 2
Creditworthiness Policy and Investment Limits

The following policies are proposed in terms of normal economic and market conditions. Given the significant volatility generated by the Covid-19 pandemic and other factors such as Brexit the limits approved may need to be varied at any time to remain viable and relevant. Accordingly the Chief Finance Officer will exercise his delegated powers “to take any decisions (including Key Decisions) and to exercise all legal powers relevant to the Council’s borrowing, investments and financial management)” (s.7.1 of the Constitution – Officer Scheme of Delegation) to achieve this.

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 9: Approved investment counterparties and limits

Credit rating	**Banks unsecured**	**Banks secured**	**Government**	**Corporates**
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a
AAA	£9m 5 years	£10m 20 years	£15m 50 years	£5m 20 years
AA+	£9m 5 years	£10m 10 years	£10m 25 years	£5m 10 years
AA	£9m 4 years	£10m 5 years		£5m 5 years
AA-	£9m 3 years	£10m 4 years		£5m 4 years
A+	£9m 2 years	£10m 3 years		£5m 3 years
A	£6m 13 months	£10m 2 years		£5m 2 years
A-	£3m 6 months	£10m 13 months		£5m 13 months
Pooled funds and real estate investment trusts		£9m per fund or trust		

This table should be read in conjunction with the notes below

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.

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.

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

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is 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.

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

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.

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.

Operational bank accounts: The Council may incur operational exposures, 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 below £500,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

NB. The Council holds a Business Reserve account as part of its operational suite of accounts with Nat West bank, this facility is classed as an investment and is not subject to the above criteria.

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.

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 new 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.

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.

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

Investment limits: The Council's revenue reserves available to cover investment losses are forecast to be £23 million on 31st March 2021. In order that no more than 50% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £10 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 10: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£10m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£18m per group
Any group of pooled funds under the same management	£20m per manager
Negotiable instruments held in a broker's nominee account	£20m per broker
Foreign countries	£10m per country
Loans to unrated corporates	£10m in total
Money market funds	£60m in total

Appendix 3

Non Treasury Investments (as at 13th November 2020)

Investment Properties

The criteria the Council has adopted for the recognition of an investment priorities is :-

A property held primarily to generate rental income or for capital appreciation or both.

A property that is used solely to facilitate delivery of services, or to facilitate delivery of services as well as rentals does not meet the definition.

Asset	**Value at 31.03.2019 ***	**Value at 31.03.2020 ***	**Year Purchased**	**Purchase Price for investment fund assets including acquisiton cost**	**Asset life for the calculation of MRP**	**Asset life at March 2020 provided by Valuer**
	£ million	£ million		£ million	years	years
Distribution Warehouse at Medway	28.8	31.2	2017/18	31.4	50	55
Ferndown	26.1	26.2	2017/18	27.5	50	50
Fugro House	19.8	19.6	2017/18	20.6	50	50
Gadeon House	15.3	15.4	2017/18	16.9	50	50
Gala Bingo Club	0.3	0.3	n/a	n/a	n/a	20
Torquay Golf Course (Petitor)	1.2	1.2	n/a	n/a	n/a	60
Unit 3 Riviera Park	0.8	0.8	n/a	n/a	n/a	25
Waterside Caravan Park	2.5	2.8	n/a	n/a	n/a	60
Wren Retail Park	18.1	11.5	2016/17	21.1	50	60
Twyver House, Gloucester	12.3	12.8	2018/19	12.5	50	40
Woodwater House Exeter	9.3	9.5	2018/19	9.9	50	60
The Range, Babbacombe	8.8	7.8	2018/19	8.8	40	60
3 Lucknow Road, Bodmin	2.8	2.9	2018/19	3.0	35	30
Travelodge, Chippenham (asset under construction as at 31/3/2019)	0.1	6.5	2019/20	6.3	35	60
Distribution facility, Exeter (asset under construction as at 31/3/2019)	2.6	15.4	2019/20	15.2	50	60
Crown Records, Exeter		1.7	2019/20	1.8	30	30
Bookers, Didcot, Oxfordshire		32.8	2019/20	34.6	40	40
Odeon, Taunton		10.5	2019/20	11.1	40	60
Total	**148.8**	**208.9**		**220.7**		

* Note: Valuation are made inline with the CIPFA Accounting Code as required for the Council's Statement of Accounts

COVID19

Please note due to COVID 19, the Council's Valuer has issued the 31st March 2020 valuation report on the basis of 'material valuation uncertainty'. This is in line with RICS guidance. Therefore a higher degree of caution should be attached to the valuation.

Loans (over £50k balance outstanding)							
All loans over £50k have received Council or Investment Committee Approval in line with Financial Regulations							
Debtor	**Value Principal**	**Loan Term (years)**	**Remaining term as at 31/03/20**	**Interest rate per annum**	**Outstanding Balance 30.03.2020**	**Note**	**Mitagation of risk**
	£ million				£ million		
South Devon College	4.0	25	22 years & 3 months	2.80%	3.6		None - Council decision to accept risk as public sector
TDA - Cockington Car Park	0.6	n/a		n/a	0.0	Not yet taken up	Wholly owned subsidiary of the Council
TDA - Unit E, Torbay Business Park	1.5	40	40 years	1.99%	1.5	New loan 2019/20	
TDA - Tor Vista - Working Capital	1.0				0.1	£0.5m - end Oct 20	
TDA - Tor Vista - Capital loan	25.0	n/a		n/a	0.0	Not yet taken up	
TDA - Kings Ash House	1.5	25	22 years & 3 months	4.50%	1.4		
THAT Group	9.3	Capital repayment starts in 2025 (7 years after the agreement)	36 years from 2025	5.25% to increase in 2023 to 8.5% over BR	9.3	New loan 2019/20	legal agreement and personal guarantee
Effect Photonics Ltd	0.5	6	6	8.00%	0.5	New loan 2019/20	Charge on the equipment
SWISCO - Working Capital	1.0				0.0	Not yet taken up	
Total	**44.4**				**16.4**		

Guarantees
None as at 31.3.20

Pension Guarantees (to Pension Fund not Employer)	Note: Any approved guarantees to new enities will be included once operational					
Employer	Nature of Guarantee **	Fund Start Date	Bond Renewal Date	Existing Bond Amount £'000	***2017 Assessed Risk £'000	Mitigation of risk
Action for Children	A	01.08.2012	31.12.2016	80	22	Council contract
Mama Bears	A	08.12.2012	08.01.2018	22	9	Council contract
Healthwatch Torbay	A	01.05.2013	Cash held in Escrow A/C with DCC	13	21	Escrow a/c
Churchill Services (Sherwell Valley)	A	01.10.2014	30.09.2017	24	7	Low value
Torbay Community Development Trust	A	01.03.2014	Cash held in Escrow A/C with DCC	21	18	Escrow a/c
Sanctuary Housing (Intergrated Domestic Abuse)	A	02.09.2014	01.10.2019	10	39	Bond in place until 1.10.19
Torbay Coast and Countryside Trust	C	01.12.1999	n/a	n/a	223	linked charity
Torbay Development Agency - see note	C	01.07.2011	n/a	n/a	525	wholly owned subsidiary
The Childrens Society (Services) Ltd	C	01.01.2014	n/a	n/a	8	Low value
SWISCo	C	01.07.2020	n/a	n/a	tbc	wholly owned subsidiary
Torbay Education Services	C	01.01.2021	n/a	n/a	tbc	wholly owned subsidiary
ISS Torbay Schools	C	01.08.2014	n/a	n/a	21	Low value
LEX Leisure (transfer of Velopark staff)	n/a	1.12.17	If deficit materialises, through LEX becoming insolvent, amount will be added to Council's existing deficit			
Libraries Unlimited (transfer of Libraries staff)	n/a	01.04.18	Any liability arising through Libraries Unlimited becoming insolvent, the amount will be added to the Council's existing fund deficit. In addtition, any liabiliity at the end of the contract will also be added to the Council's fund deficit			
Youth Service	n/a	1.2.20	Any liability arising through Youth Service becoming insolvent, the amount will be added to the Council's existing fund deficit. In addtition, any liabiliity at the end of the contract will also be added to the Council's fund deficit			
CSW Group (Cornwall Local Government Pension Scheme)	n/a	2008	Torbay Council's liability limited to 8.1% based on population			

TDA Pension Liability Pass Through

In 2019/20 the Council recognised, under a pass through arrangement, a financial guarantee for the pension liability for the TDA (a subsidiary company) that would require the Council to pay the TDA employer pension payments to the Devon County Pension Fund if the TDA defaulted on the payments. The TDA remains an admitted body to the pension scheme and is making higher employer contibutions to mitigate any financial risk to the Council. The TDA will continue to recognise a pension liability under IAS19 and also recognises an asset to the value of that IAS19 Liability. The Council's liability is therefore the value of the TDA IAS19 pension liability.

**A= Bond is required as part of the organisation's admission agreement

C= A bond is not in place and either the letting authority or a guarantor has responsibility for any residual deficit

***The summary shows the 2017 Assessed Risk Value as supplied by the Devon Local Government Pension Scheme

Subsidiary Companies (wholly owned by Torbay Council) - see Statement of Accounts 2019/20 https://www.torbay.gov.uk/media/14531/soa-1920.pdf