January 2019

Treasury Management Strategy 2019/20

incorporating the Annual Investment Strategy and the Minimum Revenue Provision Policy

Contents

1 Introduction

The Council defines its treasury management activities as:

> *"The management of the authority's borrowing, investments and cash flows, it's banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

The Strategy for 2019/20 covers two main areas:

- Treasury management issues
  - the current treasury position;
  - treasury indicators which limit the treasury risk and activities of the Council;
  - prospects for interest rates;
  - the borrowing strategy;
  - the investment strategy;
  - policy on use of external service providers;
  - reporting arrangements and management evaluation
  - other matters

- Capital issues
  - the capital plans and the prudential indicators;
  - the minimum revenue provision (MRP) policy.

2 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

The table below includes the impact of the approved capital plan (as at draft quarter three 2018/19) which shows a future borrowing requirement of £129 million (£81m Investment Fund) by 2021/22, but makes no assumption at this stage on the timing or level of the borrowing required

	2018/19 estimate	2019/20 Estimate	2020/21 Estimate
Reserves	20	15	14
Capital Funding	5	5	5
Provisions	2	2	2
Other	1	0	0
Total “core” funds	**28**	**22**	**21**
Working capital*	10	10	10
Total (under)/over borrowing	(41)	(109)	(129)
Expected cash position	**(3)**	**(77)**	**(98)**

* Working capital balances shown are estimated year end; these may be higher mid-year

Memorandum: (Under)/Over Borrowing	Note	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
-Investment Fund	1	(33)	(81)	(81)
- Other	2	(8)	(28)	(48)
Total		**(41)**	**(109)**	**(129)**

Notes

1. The approved Investment Fund of £200million has already been substantially applied to various commercial investments including retail units in Torquay and Dorset, office accommodation in Exeter and Gloucester and a distribution centre in Kent. The outstanding balance of £81m represents the amount of the Fund which has not yet been borrowed for as at 31st December 2018.
2. Other schemes relates to non-Investment Fund items within the approved Capital Plan that when these schemes progress will require borrowing including housing initiatives, town centre regeneration, Claylands, Edginswell, Harbour View car park development, etc.

3 Prospects for Interest Rates

The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their central view (at December 2018).

Link Asset Services Interest Rate View	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	0.90%	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.10%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

PWLB rates are quoted at the discounted Certainty Rate which Torbay Council is eligible for.

- Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.
- Borrowing interest rates have been volatile so far in 2018-19 and have increased modestly since the summer. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;

There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

This outlook continues to support a policy of restricting new borrowing and running down spare cash balances (Internal borrowing) to reduce net financing costs. However, this policy will need to be carefully monitored to avoid delaying borrowing to a point where rates are significantly higher than the current forecast affordable levels.

4 Borrowing

4.1 The current borrowing position

The Council's borrowing portfolio position with forward projections (excluding new borrowing) is summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement (CFR)), highlighting any over or under borrowing.

£m	2017/18 Actual	2018/19 Revised	2019/20 Estimate	2020/21 Estimate
Debt at 1 April	153	273	285	284
Change in Debt	120	12	(1)	(4)
Other long-term liabilities – School PFI	7	7	6	6
Other long-term liabilities – EFW PFI	12	12	12	12
Actual gross debt at 31 March	**292**	**304**	**302**	**298**
The Capital Financing Requirement	**280**	**345**	**411**	**427**
(Under) / over borrowing	**12**	**(41)**	**(109)**	**(129)**

The table above based on the draft quarter three 2018/19 capital monitoring report shows the Council's capital financing requirement (including PFI liabilities) rising to £427m (£200m Investment Fund) by the end of 2020/21 of which £129m is yet to be borrowed (£81m Investment Fund). This total could increase if Council approve any additional schemes to be funded from borrowing such as for additional regeneration schemes.

4.2 The Borrowing Strategy

The Council's Capital Investment Plan at quarter 3 2018/19 (draft) is detailed within the Prudential Indicators at Appendix 1. This plan and the impact on core cash, indicate the need to borrow £129 million of funds over the next three years to ensure that gross debt is in line with the CFR. If the profile of capital spend changes, the in-year treasury strategy will be updated and borrowing decisions expedited by the Chief Finance Officer under delegated powers.

It is proposed that the Council generally maintain an under borrowed position of around £10million, using existing cash resources to temporarily fund capital transactions thereby limiting the additional borrowing cost on the General Fund until income streams are realised. The timing of borrowing will be prompted by cash requirements but the Chief Finance Officer will look to take advantage of market volatility and secure funding at any point where rates fall below the forecast level.

The budget for payment of interest on debt for 2019/20 has been based on £285m of borrowing as at 20/12/18 with an overall borrowing rate of 3.34% (3.40% in 2018/19).

The Chief Finance Officer has recognised the value in aligning current low borrowing rates to the business cases of specific schemes generating new income streams and this policy is currently being applied to Investment Fund related schemes. Decisions on other schemes will be made on a case by case basis and non-applicable schemes will continue to reflect the Council's average rate of borrowing.

The outlook for interest rates in section 2 recognises the risk of deferring borrowing and exposure to higher borrowing costs. In the event of a significant rise in the outlook for interest rates, the Chief Finance Officer has delegated authority to vary the primary strategy outlined above and take a greater proportion of the borrowing requirement earlier to protect the affordability of capital schemes over the longer term.

The Council will not borrow more than, or in advance of its needs for treasury management purposes, purely in order to profit from the investment of the extra cash sums generated. (This provision does not apply to non-treasury investments whereby an income stream will be generated from the asset acquired through borrowing).

Any decision to borrow in advance, linked to forecast interest rates, will be within forward approved CFR estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds. No borrowing in advance will be made in relation to any capital project funded from borrowing until individual schemes have been approved by Council and there is a high assumption of spend occurring.

Finance officers continue to monitor alternative funding sources to PWLB. These could include borrowing from financial institutions, LGA Bond Agency and private finance. While these currently offer no advantage over PWLB, groundwork has been prepared if the Council's circumstances change in the future.

Treasury Indicators for limits to borrowing activity are published within Appendix 1 to this report.

5 Annual Investment Strategy

Investment policy

The Council's investment policy has regard to the following: -

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return).

In accordance with the above guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings. The creditworthiness policy adopted is detailed at Appendix 4.

A decision by the Chief Finance Officer to temporarily remove all Eurozone Banks, regardless of rating, from the approved counterparty list for in-house investments remains in place but does not form part of this policy.

Investment instruments identified for use in the financial year are listed at Appendix 5 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be set within the schedules accompanying the Council's Treasury Management Practices.

Investment strategy

Investment rates are forecast to improve marginally during 2019/20.

Based on strategic cash flow forecasts £15million of the Council's investments can be regarded as core cash available to be invested over a longer periods in higher risk/return instruments. £5 million of this core cash has been placed with the Local Authorities Property Fund (current yield around 4.26%). Investment of part of the remaining balance has been limited to one year deposits to track the forecast increase in rates. Further investment of residual core cash will depend on cash flow requirements and the effect of internal borrowing.

As such extensive use is expected to be made of the Council's money market funds to maintain sufficient liquidity, with fixed deposits of 3 or 6 month durations to add value to returns.

In the event that the primary strategy is varied by the CFO resulting in additional cash from new borrowing, opportunities will be sought for longer term deposits to enhance returns but likely limited to one year maximum to track forecast Bank Rate rises.

The Council's holding in the Funding Circle (peer-to-peer lending platform) is being wound down as previously approved and at 31/12/18 a balance of £56,000 remained.

The overall investment performance will be benchmarked against the 7-Day LIBID market rate and is budgeted at 0.87%

Investment treasury indicator and limits are published within Appendix 1 to this report

The Head of Finance will monitor any implications of the introduction of IRFS9 on financial instruments and the impact of any MHCLG guidance issued on statutory overrides for Local Authorities.

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 appropriate risk management framework and strategy for non-financial investments is produced in full at Appendix 6.

6 Treasury Management Consultants

Link Asset Services (formerly Capita Asset Services) was reappointed as the Council's external treasury management advisors for three years from February 2016, following a full tender process. The agreement has been extended for a further year and a new tender process will be carried out before February 2020.

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 our external service providers. All decisions will be undertaken with regard to all available information including, but not solely, our treasury advisers.

The Council also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Chief Finance Officer will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

The scope of investments within the Council's operations now includes both conventional treasury investments, (the placing of residual cash from the Council's functions), and more commercial type investments, such as investment properties. The commercial type investments are not covered by the expertise supplied by Link Asset Services and alternative specialist advice for these is obtained through the Torbay Economic Development Company.

7 Reporting Arrangements and Management Evaluation

Members will receive the following reports for 2019/20 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 CFO will inform the Mayor/Executive Lead 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 Appendix 1). 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, Finance Manager-Budget & Technical, Executive Lead for Finance and Group Leaders
- Quarterly meeting of the Treasury Manager/ Finance Manager-Budget & Technical/ Chief Finance Officer to review previous quarter performance and plan following period activities
- Regular meetings with the Council's treasury advisors
- Membership and participation in the LINK Investment Benchmarking Club
- 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 will be arranged following the Council Elections in May 2019.

The training needs of treasury management officers are periodically reviewed.

8 Other Matters

8.1 Advancing cash

If approved the Council will advance cash to Torbay Council schools at a rate equivalent to that of the forecast investment yield (to reflect the lost investment opportunity), with the option of an additional 0.25% risk premium. The service will have to identify the funding for this advance from revenue or reserves in the year of the advance.

8.2 Investing cash for Local Payment Scheme (LPS) Schools

If agreed by the Chief Finance Officer the Council will invest LPS school surplus balances on a temporary basis and endeavour to match Bank Rate on these investments on a variable basis. This will be for cash on a longer-term basis and will not apply to daily cash flow balances.

8.3 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.

8.4 Anti-Money Laundering

The Council will comply with all relevant regulations.

Appendix 1

Prudential & Treasury Management Indicators 2018/19 – 2020/21

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

Capital Expenditure

The Council's Capital Plan monitoring report for quarter 3 (draft) is summarised below for approval as the required prudential indicators for capital expenditure.

Capital expenditure at quarter 3 2018/19 (draft) £m	2018/19 Revised	2019/20 Estimate	2020/21 Estimate
Services	39	61	27
Commercial Activities/non-financial investments	55	26	0
Total	94	87	27

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of funding resources results in a borrowing need.

Financing of capital expenditure £m (quarter 3 18/19 draft)	2018/19 Revised	2019/20 Estimate	2020/21 Estimate
Capital receipts	2	1	0
Capital grants	20	11	3
Capital reserves	1	2	0
Capital Contributions	1	0	0
Revenue	0	1	0
Net financing (Borrowing) need for the year	**70**	**72**	**24**

The net financing need for commercial activities / non-financial investments included in the above table against expenditure is shown below:

Commercial activities / non-financial investments £m	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Capital Expenditure	55	26	0
Financing costs	0.0	0.0	0.0
Net financing (Borrowing) need for the year	**55**	**26**	**0**
Percentage of total net financing need	79%	36%	0

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, 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 borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include the financing of the asset and so the Council is not required to separately borrow for these schemes. The Council currently has £20m of such schemes, mostly PFI schemes, within the CFR.

The Council is asked to approve the CFR projections below:

£m	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Capital Financing Requirement			
Total CFR	**345**	**411**	**427**
Movement in CFR	**65**	**66**	**16**

Movement in CFR represented by			
Net financing need for the year (above)	70	72	23
Less MRP, VRP and other financing movements	(5)	(6)	(7)
Movement in CFR	**65**	**66**	**16**

External Debt

The Operational Boundary

This is the limit beyond which external borrowing and long-term liabilities are not normally expected to exceed. In most cases, this would be linked to the CFR, but may be lower or higher depending on the levels of actual borrowing and the ability to fund under-borrowing by other cash resources.

Operational boundary £m	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Borrowing	450	450	450	450
Long term liabilities	20	20	20	20
Total	470	470	470	470

The Authorised Limit for external borrowing and long-term liabilities.

This is a key prudential indicator represents a control on the maximum level of borrowing. It represents a limit beyond which external borrowing is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.
This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

Authorised limit £m	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Borrowing	500	500	500	500
Other long term liabilities	20	20	20	20
Total	520	520	520	520

A comparison of Gross Debt and the Capital Financing Requirement is also a key indicator of prudence. This indicator is to ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years.

£m	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Debt at 1 April	273	285	284
Change in Debt	12	(1)	(4)
Other long-term liabilities – School PFI	7	6	6
Other long-term liabilities – EFW PFI	12	12	12
Gross Debt at 31 March	**304**	**302**	**298**
Capital Financing Requirement	**345**	**411**	**427**
(Under) / over borrowing	**(41)**	**(109)**	**(129)**

Affordability

To assess the affordability of a council's capital programme, the following indicators provide an indication of the impact of the capital investment plans on the Council's overall finances.

Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream For Torbay investment income includes income from investment fund properties and the effect of this is also shown as an additional, local indicator.

£M	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Net Revenue Stream	£112m	£111m	£111m
Financing Costs Interest Paid & MRP as at 31/03/18 Interest Received	 £14m (£1m)	 £15m (£1m)	 £16m (£1m)
Sub Total	£13m	£14m	£15m
Percentage of Financing Costs to Net Revenue Stream	**12%**	**13%**	**14%**
Financing costs excludes income from Investment Property portfolio which is included within the Net Revenue Stream. *Gross Rental Income (as at Sept 18)*	£(9)m	£(10)m	£(10)m
Percentage of Financing Costs to Net Revenue Stream including Investment Property Gross Rental Income	4%	4%	5%

Each £1m of new debt costs £70,000 per annum. Therefore, borrowing £129m for the under borrowing by 2020/21, the borrowing cost of the £129m would be approx. £9m per annum in MRP and interest.

Maturity structure of borrowing

Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

Maturity structure of fixed interest rate borrowing 2019/20		
	Lower	**Upper**
Under 12 months	0%	30%
12 months to 2 years	0%	30%
2 years to 5 years	0%	30%
5 years to 10 years	0%	40%
10 years to 20 years	0%	50%
20 years to 30 years	0%	60%
30 years to 40 years	0%	50%
40 years to 50 years	0%	50%

Investment treasury indicator and limit

Total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

Upper limit for principal sums invested for longer than 365 days			
£m	**2019/20**	**2020/21**	**2021/22**
Principal sums invested for longer than 365 days	£m 20	£m 20	£m 20
Current investments (as at 31/12/18) in excess of 1 year	5	5	5

Appendix 2

Policy on Minimum Revenue Provision for 2019/20

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, less any repayment to date, the Council will make a provision 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 below).

The MRP for each asset will be calculated on the asset life method using an annuity calculation. An adjustment to the MRP calculation will be made where there is expenditure in the previous financial year, but the asset is not yet operational. 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 Head of Finance will be reviewing in 2019/20 the annuity rates used in the MRP calculation.

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 (or a straight line basis if no MRP on the asset). 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 (LINK Finance and Accounting) (England) Regulations 2008.

If a loan agreement does not include contractual commitments that the funds be put towards capital expenditure no MRP will be made, if however capital contract commitments are included then an MRP will be made on a prudent basis using Asset Life Method linked to the life of the asset being funded.

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 in the future where the capital receipts from that sale will be set aside to enable repayment of the borrowing associated with the asset. These assets will be reviewed each year to asses any reduction in value including acquisition costs. If any reduction in value has occurred then an MRP will be charged to recover the loss in the medium term, such as over five to ten years.

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

Each asset life will be considered in relation the asset being constructed by the Chief Finance Officer; 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 3

Economic Summary (Link Asset Services – January 2019)

The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth has been healthy since that meeting, but is expected to weaken somewhat during the last quarter of 2018. At their November meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. The next increase in Bank Rate is therefore forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.00 – 2.25% in September 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We have, therefore, seen US 10 year bond Treasury yields rise above 3.2% during October 2018 and also seen investors causing a sharp fall in equity prices as they sold out of holding riskier assets.

Rising bond yields in the US have also caused some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure has been dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

Appendix 4
Creditworthiness Policy

This Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands, illustrated below, which indicate the relative creditworthiness of counterparties. The Chief Finance Officer applies and reviews suitable financial and durational limits to each of these bands.

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
up to 5yrs	up to 5yrs	up to 5yrs	up to 2yrs	up to 2yrs	up to 1yr	up to 6mths	up to 100days	no colour

The Link Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances, consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored on a monthly basis and for each investment transaction. The Council is alerted to changes to ratings of all three agencies through its use of the LINK Asset Services' creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by LINK Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition the CFO will also use market data and market information, information on any external support for banks to help support its decision making process.

UK banks – ring fencing

In order to improve the resilience and resolvability of the banking sector, the largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits) are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

Sovereign ratings

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA+ and also have banks operating in sterling markets. The exception to this is the United Kingdom which has been exempted from the rating criteria to ensure cash services can continue to operate following a downgrade to AA.

The list of countries that qualify using this credit criteria as at the date of this report (based on the lowest available rating) are shown below and this list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

AAA		**AA+**
Australia	Netherlands	
Canada	Norway	Finland
Denmark	Singapore	U.S.A
Germany	Sweden	
Luxembourg	Switzerland	
Exempted from Sovereign Rating Criteria		
United Kingdom		

Appendix 5

Approved Investment Instruments: Specified and Non-Specified

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the categories below .

Specified Investments

All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable.

Investment Type	Minimum 'High' Credit Criteria
Debt Management Agency Deposit Facility	--
UK Government gilts	UK sovereign rating
UK Government Treasury Bills	UK sovereign rating
Term deposits – local authorities	LAs and other public bodies classified as colour band "Yellow"
Term deposits – banks and building societies	Creditworthiness system colour band "Green" and above
UK part nationalised banks	Creditworthiness system colour band blue
Banks part nationalised by high credit rated (sovereign rating) countries – non UK	Sovereign rating AA+
Bonds issued by multilateral development banks	AA+
Money Market Funds (CNAV)	MMF rating AAA
Money Market Funds (LVNAV)	MMF rating AAA
Money Market Funds (VNAV)	MMF rating AAA
Ultra-Short Dated Bond Funds with a credit score of 1.25	*MMF/bond fund rating AAA
Ultra-Short Dated Bond Funds with a credit score of 1.5	*MMF/bond fund rating AAA
Bond Funds	* bond fund rating AAA
Gilt Funds	UK sovereign rating

Non-Specified Investments

Investment instruments with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

Investment Type	Minimum Credit Criteria	Max investment or % of total investments	Max. maturity period *
UK nationalised/part-nationalised banks (maturities over one year)	Creditworthiness system colour band "Blue"	50%	2 years
Term deposits (over one year) – local authorities and other public sector bodies	LAs and other public bodies classified as colour band "Yellow"	50%	5 years
Term deposits (over one year) – banks and building societies	Creditworthiness system colour band "Purple"	75%	2 years
Certificates of deposits issued by banks and building societies (maturities under one year)	Creditworthiness system colour band "Green" and above	50%	1 year
Certificates of deposits issued by banks and building societies (maturities over one year)	Creditworthiness system colour band "Purple"	50%	1 year
UK Government Gilts	UK sovereign rating	100%	5 years
Bonds issued by multilateral development banks	AA+	50%	5 years
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government e.g. National Rail	UK sovereign rating	50%	5 years
Sovereign bond issues (other than the UK govt)	Sovereign rating AA+	50%	5 years
Structured Deposits (Fixed term maturities with variable rate and variable maturities)	Creditworthiness system colour band "Orange" <1 year "Purple" >1 year	25%	2 years
Commercial paper	Creditworthiness system colour band "Red" and above	35%	5 years
Floating Rate Notes	Long-term AA	35%	5 years
Property Fund: *the use of these investments would normally constitute capital expenditure*	--	£10million	5 years
Property Fund: *not classified as capital expenditure*	--	£10million	5 years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs):- 1.Corporate Bond Funds 2.Gilt Funds	AAA	35%	5 years
Corporate Bonds	AA	35%	5 years
Multi Asset Funds	--	35%	5 years
Peer to Peer Lending	Funding Circle rating B or equivalent	£500,000 Individual loan - £2,000	5 years

Appendix 6

Non Treasury Investments Strategy

Background

As clarification the following descriptions have been used

- “Investments – Yield” .These are property purchases where the objective is to increase rental income to the Council with an additional “multiple benefit” to the Council

- “Investments – Loans or Co Investment” .These are loans to business for capital expenditure where the objective is to increase rental income and/or interest returns to the Council. Co Investment is where Council with another investor provides finance or jointly purchases, with an additional ‘multiple benefit’ to the Council.

- “Regeneration” – these are property purchases, private sector or Council development projects within Torbay with the aim of increasing regeneration within Torbay.

This appendix sets out an outline for the management of the Investment and Regeneration Fund including purchases/investments and loans. The approach adopted should reflect a suitable balance between the risks inherent in the types of property/investments and loans to be acquired and the financial rewards obtainable whilst limiting risks appropriately. In addition, the portfolio of investments being acquired should be diversified in order to spread risks via a balanced portfolio, such diversification principally being across geographical location and the use type of properties held.

The risks of investing in property may be mitigated through the acquisition of assets with secure, long income streams. This needs to be balanced against the requirement for a given level of income yield on capital invested in a careful and controlled manner, with specific analysis of risk criteria carried out in the ‘due diligence’ stage prior to the completion of each purchase.

Achieving a spread of risk across a greater number of assets and by acquiring properties across the range of different property asset classes, namely retail, leisure, office and industrial, is to be desired, however it has to be recognised that opportunities to do this may not arise, and ultimately if individual business cases are robust groupings in any individual property class should not pose any increased risk to the Council.

The principle of being relatively risk-averse by limiting fresh investment to properties with good unexpired lease terms, and with tenants of strong financial standing, will be adopted.

All properties will be reviewed by nominated officers on a quarterly basis to review each property for potential disposal or investment depending on both current and future asset values and rental streams. Officers to include Monitoring Officer, Chief Finance Officer and lead Council officer for asset management. These officers to use external support as required.

Minimum and maximum yield

	Investment - Yield	**Investment- loans & co investment**	**Regeneration**
Yield	Rental	Loan repayments or rental	Rental
Target Yield Required	1.25% above forecast borrowing costs and forecast relevant ongoing costs Yield to be an average of an appropriate initial five year period	If capital loan 2% above forecast borrowing rates and forecast relevant ongoing costs Yield to be an average of an appropriate initial five year period	0% above forecast borrowing costs and forecast relevant ongoing costs Yield to be an average of an appropriate initial five year period Forecast to be subject to sensitivity analysis of estimates to ensure a 0% return can be realistically achieved.

Assets or loans producing initial yields in excess of 10.0% are likely to exhibit high risk characteristics, such as very short unexpired leases, or financially weak or insubstantial tenants, or obsolete buildings and are therefore to be the subject of very careful analysis before a decision is made.

Assessment of risks

	Investment - Yield	**Investment- loans**	**Regeneration**
Independent Valuation of asset	Yes	If applicable	If applicable
Condition Survey	Yes	If applicable	If applicable
Independent Assessment of Asset Life	Yes	If applicable	If applicable
Independent Assessment of Residual value	Yes	If applicable	If applicable
Independent Assessment of legal issues in relation to site	Yes	If applicable	Yes
Independent Assessment of future rental	Yes – future rent reviews and on lease break/expiry	If applicable	Yes – future rent reviews and on lease break/expiry
Security required	-	As appropriate to the identified risk	-
Financial Assessment of tenant or loanee	Yes	Yes	Yes
Pre commitment required	As appropriate to the identified risk	As appropriate to the identified risk	As appropriate to the identified risk t

	Investment - Yield	Investment- loans & co investment	Regeneration
Risk Appetite	Risk averse	Risk averse	Risk neutral
Consideration of State Aid	-	Yes	Yes
"Green Book" Financial profile over life of asset (IRR)	Yes	Yes	Yes
MRP	Yes – over asset life	No – of loan expected to be repaid – annual assessment required	Yes – over asset life
Assessment of impact on Council of any potentially abortive costs and how funded	Yes	Yes	Yes
Assessment of impact on Council of default or significant loss in value and how funded	Yes	Yes – Impairment (or contingency for) to be assessed on annual basis by CFO	Yes
Allowance for future costs, income shortfall and management of assets	An indicative amount of 0.25% - on total purchase costs per annum – but actual amount to be calculated on the specifics of the proposal	-	An indicative amount of 0.25% - on total costs per annum – but actual amount to be calculated on the specifics of the proposal
Lease	Tenants of good financial standing and a good remaining lease term	Loanee of strong financial standing	Tenants of good financial standing and a good remaining lease term
Loan	-	Interest rate to be linked to assessed financial risk Enforceable security required on all loans Interest required on a quarterly basis from start of loan Loan to be on a repayment basis as soon as possible	-
Reputational Issues	No "sin" assets or tenants	No "sin" assets or tenants	No "sin" assets or tenants

A rigorous assessment of all risks is required in each case of fresh investment in order firstly to value each property and then to check its suitability for inclusion in the portfolio. The risks fall into two categories, firstly economic and property market risks in specific property market sub-sectors and locations and secondly asset-specific risks (as set out below). These can be measured and an assessment made of the likely future performance of the investment carried out based on the ranges of likely future rental growth of the property and also the projected disposal price or capital value at the end of the period over which the cash flow analysis is being measured. Financial returns are modelled over a medium-term horizon of five years, based on proposed offer prices, to determine the acceptability of each investment, and can be compared against general market forecasts. Internal Rate of Return (IRR) calculations will be carried out to model the expected cash flows from each investment. The anticipated returns can be modelled on different bases to reflect the range of risks applicable in each case, to ensure that forecast returns properly reflect the measured risks. In this way a Business Case is put together to support each recommended property acquisition.

Allowance for future costs, income shortfall and management of assets

For each purchase or development an allowance is to be made to cover the following issues:

- Future management costs of the asset – both ongoing costs such as liaison with tenants, asset inspections, insurance arrangements, service charge management, lease term enforcement and management of site but also cyclical costs such as rent reviews, marketing of vacant space, investment in assets and potential disposal.
- Future void or rent free periods on asset
- Future landlord repair and maintenance and investment costs in asset
- Abortive costs or set up/feasibility costs not chargeable as capital expenditure a purchase associated with the potential purchase or development of assets

The table above gives an indicative value based on a percentage of total purchase costs to be set aside each year. The Chief Finance Officer will vary this percentage depending on an assessment of future issues and costs relevant to each asset – e.g. the expectation of an extended rent free period.

Asset-specific risks

Income and capital returns for property will depend principally on the following five main characteristics;
• Location of property
• Building specification quality
• Length of lease unexpired
• Financial strength of tenant(s)
• Rental levels payable relative to current open market rental values

Location – this is the single most important factor in considering any property investment. In the retail sector prime or good secondary locations in major regional or sub-regional shopping centres are likely to provide good long-term prospects, or alternatively prime locations in sub-regional or market towns.

Industrial and warehouse property has a wider spectrum of acceptable locations with accessibility on good roads to the trunk road and motorway network being the key aspect.

Experienced knowledge will be required to ensure that good locations are selected where property will hold its value in the long term.

Building specification quality – In office property especially it is important to minimise the risk of obsolescence in building elements, notably mechanical and electrical plant. Modern, recently-built office and industrial property should be acquired to ensure longer-term income-production and awareness of the life-cycle of different building elements and costs of replacement is critical in assessing each property’s merits. For town centre retail property trends have been towards larger standard retail units being in strongest demand from retailers.

Length of lease unexpired – At present capital values are highest for long-term leased property and values tend to reduce significantly when unexpired lease terms fall below five years, as owners expect significant capital expenditure to be necessary when leases expire and tenants may not renew leases and continue to occupy. Fresh investments should be made ensuring that diminishing lease terms will not either adversely affect capital value or that significant capital expenditure and voids are experienced.

Financial strength of tenant(s) – assessment will be required of each tenant of potential acquisitions through analysis of their published accounts and management accounts where necessary. Risk of tenant default in rent payment is the main issue but the relative strength of a tenant’s financial standing also impacts upon capital value of property which is let to that tenant and careful analysis of financial strength is a key part of due diligence prior to purchase of investments.

Rental levels – care is required in all purchases to assess market rents local to each property to check whether rents payable under leases are above or below current levels, as this will impact on whether growth in rents in the future will be fully reflected in the specific property being analysed.

Environmental and regulatory risks - Risks such as flooding and energy performance are taken into account during the due diligence process on every property purchase.

Reputational risks – An assessment of any reputational risks will be undertaken in respect of all proposals, and this will be a relevant factor in decision making.