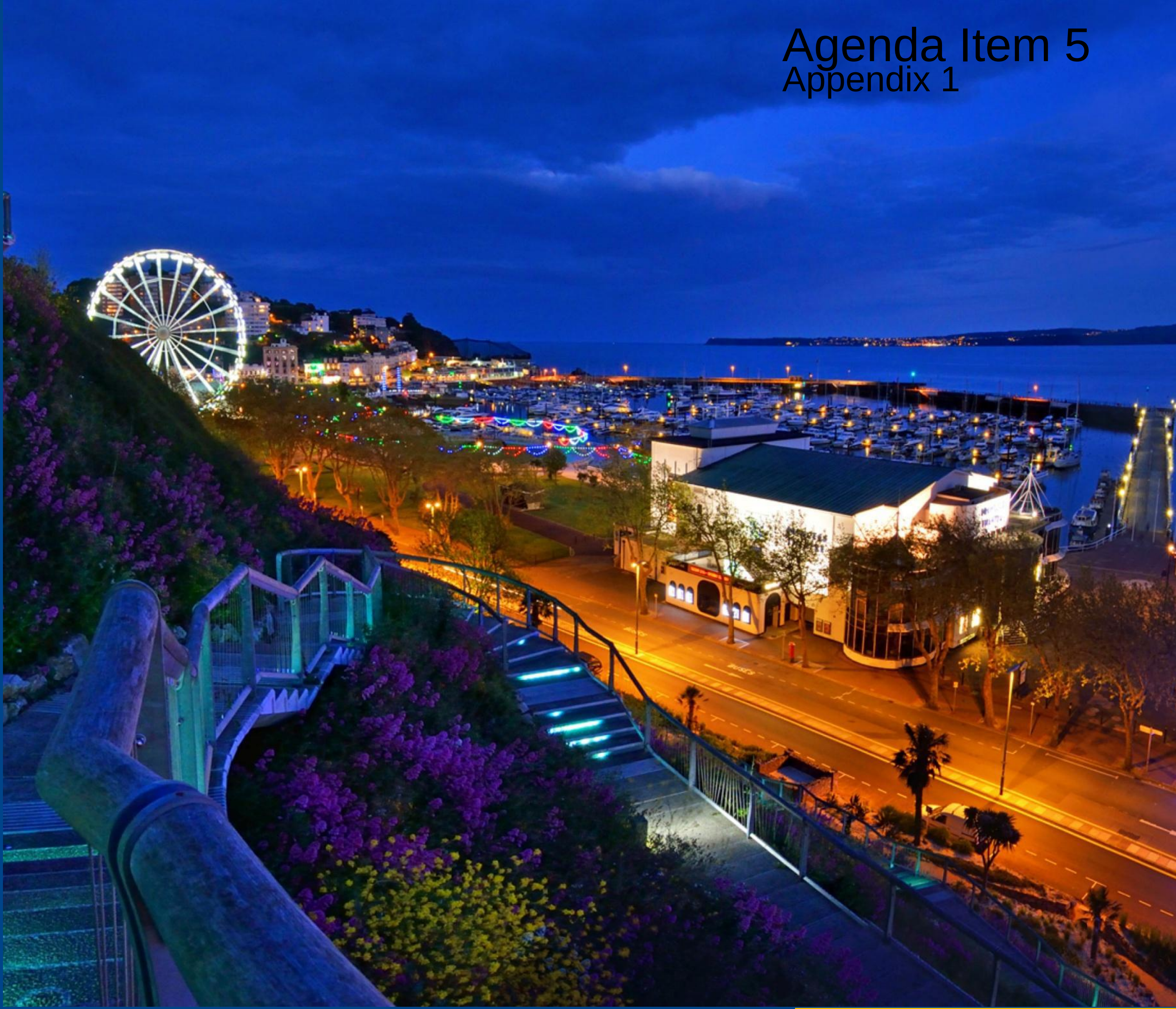

January 2020

Treasury Management Strategy 2020/21

incorporating the Annual Investment Strategy and the Minimum Revenue Provision Policy

TORBAY COUNCIL

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 2020/21 covers two main areas:

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

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

2 Capital

The Council's capital expenditure plans are the key driver of treasury management activity and the output of the capital expenditure plans is reflected in the prudential indicators required by the Prudential Code.

The prudential indicators for 2020/21 and future years are detailed for approval by Council within Appendix 1 and headlined below (based on quarter 3 figures).

£m	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Capital Expenditure	125	143	74	51
Net Borrowing Need	106	127	63	50
Capital Financing Requirement	422	542	596	635
Total Gross Borrowing at end of year	393	389	385	380

3 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.).

The table below includes the impact of the approved capital plan (as at quarter three 2019/20) which shows a future borrowing requirement of £255 million (£88m Investment Fund) by 2022/23, but makes no assumption at this stage on the timing or level of the borrowing required

	2019/20 estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Reserves	20	13	13	15
Capital Funding	10	10	5	5
Provisions	4	4	2	2
Other	(7)	(7)	(7)	(7)
Total "core" funds	**27**	**20**	**13**	**15**
Working capital*	15	15	15	15
Total (under)/over borrowing	(30)	(153)	(210)	(255)
Expected cash position	**12**	**(118)**	**(182)**	**(225)**

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

In addition any slippage on the capital plan will both increase the cash figure and reduce the under borrowing figure.

Memorandum: (Under)/Over Borrowing	Note	2019/20 estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
- Investment Fund	1	(23)	(88)	(88)	(88)
- Other	2	(7)	(65)	(122)	(167)
Total		**(30)**	**(153)**	**(210)**	**(255)**

Notes

1. The approved Investment Fund of £300million has already been substantially applied to various commercial investments including retail units in Torquay and Dorset, office accommodation in Exeter and Gloucester, a distribution centre in Kent and a cinema in Taunton. The outstanding balance of £88m represents the amount of the Fund which has not yet been borrowed for as at 31st December 2019.
2. Other schemes relates to non-Investment Fund items within the approved Capital Plan that, when progressed, will require borrowing including housing initiatives, regeneration, Harbour View car park development, etc.

4 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 2020).

Link Asset Services Interest Rate View	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.60	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.20	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.10	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

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

- Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress was made with an agreed Brexit, then there is upside potential for earnings.
- Borrowing interest rates (PWLB) were on a major falling trend during the first half of 2019-20 but then jumped up by 100 bps on 9.10.19 following a government decision. However, the unexpected increase of 100 bps in PWLB rates has required a major review of local authority treasury management strategy and risk management.

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.

5 Borrowing

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	2018/19 Actual	2019/20 Revised	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Debt at 1 April	273	303	375	371	368
Change in Debt	30	72	(4)	(3)	(4)
Other long-term liabilities – School PFI	6	6	6	5	4
Other long-term liabilities – EFW PFI	12	12	12	12	12
Actual gross debt at 31 March	**321**	**393**	**389**	**385**	**380**
The Capital Financing Requirement	**321**	**422**	**542**	**596**	**635**
(Under) / over borrowing	0	(29)	(153)	(211)	(255)

The forecasts above, based on the quarter three 2019/20 capital monitoring report, shows the Council's capital financing requirement (including PFI liabilities) rising to £635m (£300m Investment Fund) by the end of 2022/23 of which £255m is yet to be borrowed (£88m Investment Fund). This total could increase if Council approve any additional schemes to be funded from borrowing such as for new regeneration opportunities.

The Borrowing Strategy

The Council is currently maintaining an under-borrowed position, in line with the current strategy. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

The current level of under-borrowing is exaggerated by a partial suspension of new borrowing following the decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100 bps to 180 basis points on loans lent to local authorities. This immediately raised the rates payable by the Council by one per cent.

In light of this decision, alternative borrowing options are being considered, including:

- Local authorities (primarily shorter dated maturities)
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of spot or forward dates)
- Municipal Bonds Agency (no issuance at present but there is potential)

The evaluation process is likely to be concluded after submission of this Strategy document. Until then the Chief Officer is limiting new PWLB borrowing to 50% of Investment Fund transactions; this to ensure sufficient liquidity and act as protection against market lenders declining funding for commercial activities or applying a premium to the rate. Funding in the interim period will be from existing cash resources or temporary, short term borrowing from the market.

The degree to which any of these options proves cheaper than PWLB Certainty Rate is still evolving at the time of writing but with the impact of potential fees and resourcing issues there could be a case that the PWLB will remain the optimum lending source.

Should the profile of capital spend change from that reported above, 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 in the longer term, 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 2020/21 has been based on an assumed £375m of borrowing as at 31/03/20 with an overall borrowing rate of 3.03% (3.34% in 2019/20).

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 3 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 bodies the Council can borrow from are listed in the Schedules to the approved Treasury management Practices which include PWLB, UK Municipal Bonds Agencies and specified financial institutions.

Policy on borrowing in advance of need

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.

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..

Debt rescheduling

Rescheduling of current borrowing in the debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates imposed on 9th October 2019 only applied to new borrowing rates and not to premature debt repayment rates. The increased disparity between the two sets of rates give rise to excessive penalty calculation for early repayment of loans.

For example repayment of a specimen portfolio loan of £2M with a rate of 4.1% and 20 years to maturity would cost £3.1M on current levels.

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

6 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).

The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. 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 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

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 4.82%). A longer term deposit to November 2021 was taken at 1.00% to protect against a possible cut in Bank Rate.

The remaining investment balance will initially be held as liquid as possible to internally fund the capital borrowing requirement discussed in section 4. As such extensive use is expected to be made of the Council's money market funds and notice accounts.

In the event of new borrowing being taken, opportunities will be sought for longer term deposits to enhance returns in line with the static rate forecast, mainly limited to one year maximum to maintain ongoing liquidity requirements.

The overall investment performance will be benchmarked against the 7-Day LIBID market rate and is budgeted at 1.12%

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

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 6. All decision have followed appropriate risk management framework and strategy for non-financial investments approved by Council in February 2019.

7 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 until 30th April 2020 and a new tender process will be carried out to appoint an advisor beyond this date.

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 0f 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 Development Agency.

8 Reporting Arrangements and Management Evaluation

Members will receive the following reports for 2020/21 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 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, Leader of the Council, Cabinet Member for Finance and Independent Group Leader.
- 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
- 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 was made available to Audit Committee members in June 2019. Further training for all Members will be arranged following appointment of the Treasury Management advisor contract from 1st May 2020.

The training needs of treasury management officers are periodically reviewed.

9 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 IRFS9 on financial instruments.

Appendix 1

Prudential & Treasury Management Indicators 2020/21 – 2022/23

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 below, which are designed to assist Members' overview and confirm capital expenditure plans.

Capital Expenditure

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

Capital expenditure at quarter 3 2019/20 £m	**2019/20 Revised**	**2020/21 Estimate**	**2021/22 Estimate**	**2022/23 Estimate**
Services	45	78	74	51
Commercial Activities/non-financial investments	80	65	0	0
Total	125	143	74	51

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.

Capital expenditure at quarter 3 2019/20 £m	**2019/20 Revised**	**2020/21 Estimate**	**2021/22 Estimate**	**2022/23 Estimate**
Capital receipts	1	2	5	0
Capital grants	14	11	6	1
Capital reserves	1	2	0	0
Capital Contributions	2	1	0	0
Revenue	1	0	0	0
Net financing (Borrowing) need for the year	**106**	**127**	**63**	**50**

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	2019/20 Revised	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Capital Expenditure	80	65	0	0
Percentage of total net financing need	75%	51%	0	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 and if applicable 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 CFR projections are detailed below for Council approval.

£m	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Capital Financing Requirement				
Total CFR	**422**	**542**	**596**	**635**
Movement in CFR	101	120	54	39
Movement in CFR represented by				
Net financing need for the year (above)	106	127	64	49
Less MRP, VRP and other financing movements	(5)	(7)	(10)	(10)
Movement in CFR	**101**	**120**	**54**	**39**

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 a similar figure 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	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Borrowing	450	570	620	645
Long term liabilities	20	20	20	20
Total	470	590	640	665

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

This is a key prudential indicator and represents a control on the maximum level of borrowing. It represents a legal 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	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Borrowing	500	690	690	690
Other long term liabilities	20	20	20	20
Total	520	710	710	710

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	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Debt at 1 April	303	375	371	368
Change in Debt	72	(4)	(3)	(4)
Other long-term liabilities – School PFI	6	6	5	4
Other long-term liabilities – EFW PFI	12	12	12	12
Gross Debt at 31 March	**393**	**389**	**385**	**380**
Capital Financing Requirement	**422**	**542**	**596**	**635**
(Under) / over borrowing	(29)	(153)	(211)	(255)

Affordability

To assess the affordability of the Council's capital investment plans, the following indicators provide an indication of the impact 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	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Net Revenue Stream	£111m	£116m	£116m	£116m
Financing Costs Interest Paid & MRP as at 31/03/20 Interest Received Sub Total	 £15m (£1m) £14m	 £21m (£1m) £20m	 £21m (£1m) £20m	 £21m (£1m) £20m
Percentage of Financing Costs to Net Revenue Stream	13%	**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 18)*	£(10)m	£(15)m	£(15)m	£(15)m
Percentage of Financing Costs to Net Revenue Stream including Investment Property Gross Rental Income	4%	5%	5%	5%

Each £1m of new debt costs £70,000 per annum. Therefore, borrowing £255m for the under borrowing by 2020/21 would cost approximately £18m 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 2020/21		
	Lower	**Upper**
Under 12 months	0%	40%
12 months to 2 years	0%	40%
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**	**2021/22**
Principal sums invested for longer than 365 days	£m 20	£m 20	£m 20	£m 20
Current investments (as at 31/12/19) in excess of 1 year	10	10	5	5

Appendix 2
Policy on Minimum Revenue Provision for 2020/21

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 3
Economic Summary (as provided by Link Asset Services – December 2020)

It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit and the outcome of the general election. In its meeting on 7 November, the MPC became more dovish due to increased concerns over the outlook for the domestic economy if Brexit uncertainties were to become more entrenched, and for weak global economic growth: if those uncertainties were to materialise, then the MPC were likely to cut Bank Rate. However, if they were both to dissipate, then rates would need to rise at a "gradual pace and to a limited extent". Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. There is still some residual risk that the MPC could cut Bank Rate as the UK economy is still likely to only grow weakly in 2020 due to continuing uncertainty over whether there could effectively be a no deal Brexit in December 2020 if agreement on a trade deal is not reached with the EU. Until that major uncertainty is removed, or the period for agreeing a deal is extended, it is unlikely that the MPC would raise Bank Rate.

Bond yields / PWLB rates. There has been much speculation during 2019 that the bond market has gone into a bubble, as evidenced by high bond prices and remarkably low yields. However, given the context that there have been heightened expectations that the US was heading for a recession in 2020, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated, as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

During the first half of 2019-20 to 30 September, gilt yields plunged and caused a near halving of longer term PWLB rates to completely unprecedented historic low levels. *(See paragraph 3.7 for comments on the increase in the PWLB rates margin over gilt yields of 100bps introduced on 9.10.19.)* There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but also in the UK due to a correlation between US treasuries and UK gilts; at various times this correlation has been strong but at other times weak. However, forecasting the timing of this, and how strong the correlation is likely to be, is very difficult to forecast with any degree of confidence. Changes in UK Bank Rate will also impact on gilt yields.

One potential danger that may be lurking in investor minds is that Japan has become mired in a twenty-year bog of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that this condition might become contagious to other western economies.

Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt-fuelled boom that now makes it harder for central banks to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

In addition, PWLB rates are subject to ad hoc decisions by **H.M. Treasury** to change the margin over gilt yields charged in PWLB rates: such changes could be up or down. It is not clear that if gilt yields were to rise back up again by over 100bps within the next year or so, whether H M Treasury would remove the extra 100 bps margin implemented on 9.10.19.

Economic and interest rate forecasting remains difficult with so many influences weighing on UK gilt yields and PWLB rates. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

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:

- 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

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 the UK and from countries with a minimum sovereign credit rating of 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	
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/Colour Band**
Debt Management Agency Deposit Facility	Yellow
UK Government gilts	Yellow
UK Government Treasury Bills	Yellow
Term deposits – local authorities	Yellow
Term deposits – banks and building societies	Green and above
UK part nationalised banks	Blue
Bonds issued by multilateral development banks	Yellow
Money Market Funds (CNAV)	AAA
Money Market Funds (LVNAV)	AAA
Money Market Funds (VNAV)	AAA
Ultra-Short Dated Bond Funds with a credit score of 1.25	AAA
Ultra-Short Dated Bond Funds with a credit score of 1.5	AAA

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)	Blue	50%	2 years
Term deposits (over one year) – local authorities and other public sector bodies	Yellow	50%	5 years
Term deposits (any maturity) – Housing Associations	Equivalent to AA+	35%	2 years
Term deposits (over one year) – banks and building societies	Purple	75%	2 years
Certificates of deposits issued by banks and building societies (maturities under one year)	Green	50%	1 year
Certificates of deposits issued by banks and building societies (maturities over one year)	Purple	50%	2 years
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	AA	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 (as at 15th January 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 ***	**Year Purchased**	**Purchase Price for investment fund assets including acquisiton cost**	**Asset life for the calculation of MRP**	**Asset life at March 2019 provided by Valuer**
	£ million		£ million	years	years
Distribution Warehouse at Medway	28.8	2017/18	31.4	50	60
Ferndown	26.1	2017/18	27.5	50	50
Fugro House	19.8	2017/18	20.6	50	50
Gadeon House	15.3	2017/18	16.9	50	50
Gala Bingo Club	0.3	n/a	n/a	n/a	n/a
Torquay Golf Course (Petitor)	1.2	n/a	n/a	n/a	n/a
Unit 3 Riviera Park	0.8	n/a	n/a	n/a	n/a
Waterside Caravan Park	2.5	n/a	n/a	n/a	n/a
Wren Retail Park	18.1	2016/17	21.1	50	61
Twyver House, Gloucester Purchase Price £12m	12.3	2018/19	12.5	50	40
Woodwater House Exeter Purchase Price £10m	9.3	2018/19	9.9	50	60
The Range, Babbacombe	8.8	2018/19	8.8	40	60
3 Lucknow Road, Bodmin	2.8	2018/19	3.0	35	30
Travelodge, Chippenham (asset under construction as at 31/3/2019)	0.1	2019/20	6.3	35	n/a
Distribution facility, Exeter (asset under construction as at 31/3/2019)	2.6	2019/20	14.7	50	n/a
Sub Total as at 31.3.19	**148.8**		**172.7**		
2019/20 investments as at 15/01/2020					
Crown Records, Exeter		2019/20	1.8	50	n/a
Bookers, Didcot, Oxfordshire		2019/20	34.6	40	n/a
Odeon, Taunton		2019/20	11.1	to be confirmed	n/a
Total			**220.2**		

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

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 31/03/19**	**Interest rate per annum**	**Outstanding Balance 31.03.2019**	**Draw Downs in 2019/20**	**Note**	**Mitagation of risk**
	£ million				£ million	£ million		
South Devon College	4.0	25	23 years & 3 months	2.80%	3.7			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	
TDA - Unit E, Torbay Business Park	1.5	40	40 years	1.99%	n/a	1.5	New loan 2019/20	Wholly owned subsidiary of the Council
TDA - Kings Ash House	1.5	25	23 years & 3 months	4.50%	1.4			

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Loans (over £50k balance outstanding)								
Care Home Provider	1.3	10	Repaid in full in quarter 3 2019/20					
Parkwood Leisure	1.7	12	12 years	4.80%	1.7			Asset leased from Council
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	n/a	5.1		legal agreement and personal guarantee
Effect Photonics Ltd	0.5	6	6	8.00%	n/a	0.2	Final drawdown before 31/03/20	Charge on the equipment
Total	**20.4**				**6.8**	**6.6**		

Guarantees
None as at 31.3.19

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
Tor 2 Waste (Kier PCG)	C	19.07.2010	n/a	n/a	324	pass through
Tor 2 Street Scene (Kier PCG)	C	19.07.2010	n/a	n/a	659	pass through
Tor 2 Asset Management (Kier PCG)	C	19.07.2010	n/a	n/a	632	pass through
Torbay Development Agency	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
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			
CSW Group (Cornwall Local Government Pension Scheme)	n/a	2008	Torbay Council's liability limited to 8.1% based on population			

**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 2018/19 https://www.torbay.gov.uk/media/12919/soa-1819.docx