

Report

Audit Committee



Part 1

Date: 29 January 2020

Item No: 5

Subject **DRAFT 2020/21 Capital Strategy and Treasury Management Strategy**

Purpose This report includes both the DRAFT Capital Strategy and Treasury Management Strategy for approval by the Council and confirms the capital programme. The revenue impacts of both strategies are included within the Medium Term Financial Projection (MTFP) which were approved separately by Cabinet as part of the 2020/21 budget report.

Author Head of Finance

Ward General

Summary The Council has ambitious plans for the city as set out in its new Corporate Plan and the promises set out within it. A key enabler to deliver on this ambition is the capital programme. Significant progress has been made to date and the current capital programme, ending 2024/25 is ambitious with £202m of capital spend on projects. The Council is investing over c£70m in its schools, in its historical and cultural assets such as the Transporter bridge, supporting city centre redevelopment, providing modern, fit for the future 'neighbourhood hubs' and creating capacity in its recycling and waste facilities. Progress is being made in the delivery of these.

The Council has developed a capital strategy which sets out the long-term context (10 years) in which capital decisions are made and should demonstrate that the Local Authority takes capital / investments decisions in line with service objectives, gives consideration to both risk/reward and impact; as well as properly taking account of stewardship, value for money, prudence, sustainability and affordability.

The capital plans of the Authority are inherently linked with the treasury management activities it undertakes, and therefore the Treasury Management Strategy is included alongside the capital strategy.

The main recommendations arising from the two strategies are summarised in the report below. These have been updated following comments from Audit Committee.

Proposal Audit Committee is asked to note and provide comment on:

- the updated current capital programme ending 2024/25, and the current level of headroom available for future capital expenditure, noting the associated increased revenue costs within the current Medium Term Financial Projections for funding the cost of borrowing (MTFP) (Appendix 1)

- the first Capital Strategy including Prudential Indicators and approve the borrowing limits coming from the capital programme; (Appendix 2)
- the Treasury Management Strategy and Treasury Management Indicators, the Investment Strategy and the Minimum Revenue Provision (MRP) for 2020/21. (Appendix 3)

Action by Head of Finance

Timetable Immediate

This report was prepared after consultation with:

- Chief Executive
- Strategic Directors
- All Heads of Service
- Newport Norse
- The Council's Treasury Advisors
- Accountancy Staff

Signed

Background

Context

1. The Council Corporate Plan sets out how the Council will take forward its mission of 'Improving People's Lives' and includes a set of key promises. Delivery of these will involve capital funded projects in some instances.
2. Good progress has been made in bringing forward some key schemes to date e.g. Transporter Bridge, Neighbourhood Hubs, City centre re-development, new schools. The current capital programme includes some £202m of investment in the city, which delivers on key priorities.
3. Demand however continues to exceed capital resources available and the Council has a framework which maximises available capital spend whilst keeping the cost of funding it within affordable limits. Delivery of the longer term demands will inevitably also involve how the Council works with external partners and prioritises and leverages in funding / projects from third parties.
4. In previous years the capital programme and Treasury Management Strategy were included within the budget report to Council. Due to the requirement of a new Capital Strategy and the links with treasury management decisions, it is deemed appropriate to combine the Capital Strategy and Treasury Management Strategy as a separate report for approval by Council, recognising that the revenue impact of both are included within the associated budget report.

Summary of recommendations

5. The Capital Strategy and Treasury Management Strategy detailed further in this report outline the current capital programme to 2024/25, links to treasury management decisions and a long-term view which highlight the challenges facing the authority for future capital decisions. The main recommendations and observations to Council coming from both strategies are as follows:

Capital Strategy

- i. In order to maximise capital expenditure within affordable revenue budget, capital expenditure decisions will continue to be made in line with the framework agreed in the February 2018 Council. This is detailed in paragraph 11.
- ii. Over the life of the current capital programme to 2024/25, capital expenditure funded from borrowing will be within the affordability headroom detailed in paragraphs 12-17, resulting in an increase on the revenue financing costs, which are included in the MTFP.
- iii. Notes that increasing the 'headroom' to create further capital expenditure will increase the capital financing costs for new borrowing this will entail. In the current financial climate and with an existing budget gap on the MTFP, this is challenging.
- iv. Observe that capital financing costs both for the provision of repayment of debt and interest payable budgets even without additional expenditure funded by borrowing in future programmes, are forecast to increase year on year in the long-term. Detailed in paragraph 18-24.
- v. Decisions on the level of capital expenditure for the next capital programme from 2023/24 onwards will need to be made at that point, when there is more certainty on the level of funding available, interest rates and the Council's borrowing position.
- vi. However, it is important to note the strategy highlights that the Council is likely to face a significant challenge when setting the next capital programme given the demands on the

authority and the increasing capital financing costs over the long term, even with no new capital spend funded from borrowing.

- vii. Given the above there is the need to develop our approach to using the various strategic plans of the authority (as highlighted in paragraph 25) in order to prioritise and find other ways of investing in our assets.

Treasury Management – Borrowing Strategy

- i. Whilst the capacity for further internal borrowing has reached capacity, and in 2020/21 the Council is expected to undertake external borrowing both for the refinancing of maturing loans and to fund the existing capital programme; it will remain as much 'internally borrowed' as is possible and increase actual external borrowing only when needed to manage its cash requirements. However, the Council may, where it feels necessary to mitigate the risk of interest rate rises, undertake borrowing early to secure interest rates within agreed revenue budgets. This will be done in line with advice from our Treasury Advisors.
- ii. The Council is committed to be a 'net borrower' over a long-term as shown in paragraph 20.
- iii. The borrowing limits over the medium term (paragraph 20) have been set in line with the expected borrowing required to finance the current capital programme to 2022/23. Plus, a buffer for the ability to manage day to day cash requirements, and undertake a level of borrowing early as per (i) where appropriate / affordable, and to borrow for investment/income generation schemes or regeneration investment purposes where the business case is approved within governance arrangements.
- iv. The Council's medium term financial projections (MTFP) includes the revenue costs required to finance the borrowing limits in relation to finance the capital programme as mentioned above. Where this borrowing is undertaken for the investment/income generation schemes or investment purposes the revenue costs would be offset by the income received from the investment.
- v. It is recommended given the long-term need to remain a 'net borrower', that future external borrowing will be taken over long time period taking into account the maturity profile of existing debts, in conjunction with advice from the Council's treasury advisers.

Treasury Management – Investment Strategy

- i. Both the CIPFA Code and the WG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.
- ii. Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to diversify into higher yielding asset classes during 2020/21. This is especially the case for the estimated £10 million that is available for longer-term investment. All of the Authority's surplus cash is currently invested in short-term unsecured bank deposits and local authorities. This diversification will represent a change in strategy over the coming year.

- iii. The approved counterparty list and limits are shown table 4 of Appendix 3. Due to the move into longer-term investments, pooled funds and real estate investment trusts have been included as an investment option.
- iv. Treasury indicators and limits are outlined in the strategy, these set out the investment limits across various bodies/organisations, the maturity structure of borrowing and the amount invested over one year (long-term). The limit placed on investments over one year is £10m, in line with (ii) above.
- v. The Council will also be required to borrow and invest in the short-term to manage the shorter term cash-flow requirements of the Council.

The Capital Strategy and Treasury Management Strategy are further summarised below:

Capital Strategy 2019/20 to 2028/29

6. The 'Capital Strategy 2019/20 to 2028/29' is the Council's first capital strategy following the requirement placed on Local Authorities by the 'Prudential Code for capital finance in Local Authorities (2017)' to determine a capital strategy. The capital strategy sets out the long-term context (10 years) in which capital decisions are made and should demonstrate that the Local Authority takes capital / investments decisions in line with service objectives, gives consideration to both risk/reward and impact; as well as properly taking account of stewardship, value for money, prudence, sustainability and affordability.
7. The objective of the Prudential Code is to ensure, within a clear framework, that the capital expenditure plans of local authorities are affordable, prudent and sustainable. The capital strategy sets out;
 - The need for a capital strategy and the governance arrangements.
 - The current capital programme and its financing, and the revenue cost implications for the Council arising from that.
 - The long-term (10 year) projection for the capital financing costs of the Council and where future demands arise from the various strategic plans across the authority for further capital resources.
 - Links between the Capital Strategy to Treasury Management strategy and treasury decision making.
 - An overview of the commercial activity of the Council and its strategy going forward
 - Overview of other long-term liabilities of the authority
8. The full Capital Strategy is shown in Appendix 2.
9. Council is required to approve the strategy and the prudential indicators within. This Capital Strategy is the first of its kind and will be developed over time, and will require update and approval by Council on an annual basis.
10. Key areas contained within it include the (i) current 5-year capital programme to 2022/23 and its cost of financing plus (ii) the longer-term projection for capital financing costs and these are summarised in this report below as the key issues to bring to the Council's attention.

(i) Current Capital Programme and cost of financing

11. Given the current demand and increased costs on Council services, plus funding constraints and uncertainty, Cabinet and Council established a framework in order to maximise capital expenditure but keep within a sustainable revenue budget to fund new borrowing; this was as follows:

- Funding from sources other than borrowing needs to be maximised by securing grant funding whenever possible and, maximising capital receipts
 - Regeneration schemes would be funded from ring-fencing the capital works reserve only and Joint Venture funds. Other kinds of support through the making of loans etc. would then be considered to support schemes, where it was needed and appropriate.
 - Any change and efficiency schemes or schemes which save money requiring capital expenditure would be funded by netting off the capital funding costs from those savings achieved
 - Schemes and projects which generate new sources of income would need to fund any capital expenditure associated with those schemes.
12. This framework ensures that the current capital programme can be maximised by allocating the ‘capital expenditure headroom’ for those schemes which cannot fund any resulting borrowing costs themselves through resulting savings/income generated e.g. new schools programme, and then extending capital expenditure for those other schemes which can fund the resulting revenue borrowing costs themselves or use grants/specific reserves. The ‘headroom’ is made up of uncommitted capital reserves and capital receipts, an estimated level of borrowing and a prudent estimate of future capital receipts – shown in table 1 below.
13. Funding capital spend from borrowing incurs extra revenue costs (called ‘capital financing’) for the Council from:
- Minimum Revenue Provision (MRP) – provision for repayment of the principal loan
 - Interest costs – from external loans
14. Whilst a decision can be made to increase the ‘headroom’ to create further capital expenditure, this will increase the capital financing costs for new borrowing this will entail. In the current financial climate and with an existing budget gap on the MTFP, this is challenging.
15. In February 2018 Cabinet approved a new 5-year capital programme from 2018/19 to 2022/23. This was in line with the above framework and additions are made to the programme as demand is required and capital bids are approved. The Capital Strategy explains the process by which projects are approved onto the capital programme, ensuring they meet key service priorities and in overall terms, keep within the affordability headroom.
16. The position on the current capital programme is summarised in the table below and shown in detail on Appendix 1. In 2020/21, the Council has capital schemes of £44.6m, and there is remaining headroom across the programme of £15.7m, though that is dependent on generating future capital receipts and further borrowing. Summary of the updated 7-year programme is shown in Table 1 below.

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

	7-YEAR CAPITAL PROGRAMME							Total 7-year programme £m
	2018/19 actual £m	2019/20 forecast £m	2020/21 budget £m	2021/22 budget £m	2022/23 Budget £m	2023/24 Budget £m	2024/25 Budget £m	
Approved Schemes (Appendix 1)	29.5	39.3	44.6	45.3	13.9	11.5	2.3	186.4
Uncommitted headroom to invest in council assets / regeneration*		1.0	4.9	4.9	4.9			15.7
TOTAL EXPENDITURE	29.5	40.3	49.5	50.2	18.8	11.5	2.3	202.1

*split equally across years 2019/20 to 2022/23, this can be flexed accordingly in line with need.

17. Demand for capital resources remains high and the current 'headroom' shows available capital funds over the next 4 years. In order to balance the need for further capital spend and affordability, prioritisation of capital expenditure is/will be inevitably required.
18. The programme above is increasing the capital financing costs as shown in table 2 below, and these costs are included in the Council's Medium Term Financial Projections (MTFP), which, in the current funding climate/uncertainty and continued increase on service demands, is challenging. Compared to comparative authorities, the percentage of the capital costs as a proportion to the Councils total net revenue is very high, showing the need to maintain a sustainable level of spending on capital to keep these costs down.

Table 2: Capital Financing Costs

	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget
Provision for repayment of debt (MRP)	7.9	8.3	8.9	9.2
Net interest cost	7.0	7.0	7.1	7.3
Total capital financing (exc PFI)	14.9	15.3	16.0	16.5
PFI	7.2	7.2	7.2	7.4
Total Financing costs* (£m)	22.1	22.5	23.2	23.9
Proportion of net revenue stream	7.9%	7.5%	7.6%	7.7%

*includes charges direct to service areas

19. Capital Expenditure funded by debt increases the need to undertake external borrowing. The Council is committed to be a net borrower for the long term, to ensure this borrowing is affordable and sustainable Council is required to set an affordable borrowing limit shown in Table 3 below.
20. **Affordable borrowing limit:** The Council is legally obliged to set an affordable borrowing limit (also termed the 'authorised limit' for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as an early warning level should debt approach the limit.

Table 3: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2019/20 limit	2020/21 limit	2021/22 limit	2022/23 limit
Authorised limit – borrowing	230	240	250	245
Authorised limit – PFI and leases	44	43	42	41
Authorised limit – total external debt	274	283	292	286
Operational boundary – borrowing	220	230	240	235
Operational boundary – PFI and leases	44	43	42	41
Operational boundary – total external debt	264	273	282	275

➤ Further details on borrowing are in the treasury management strategy

The above limits look at the following factors and are set providing flexibility for these:

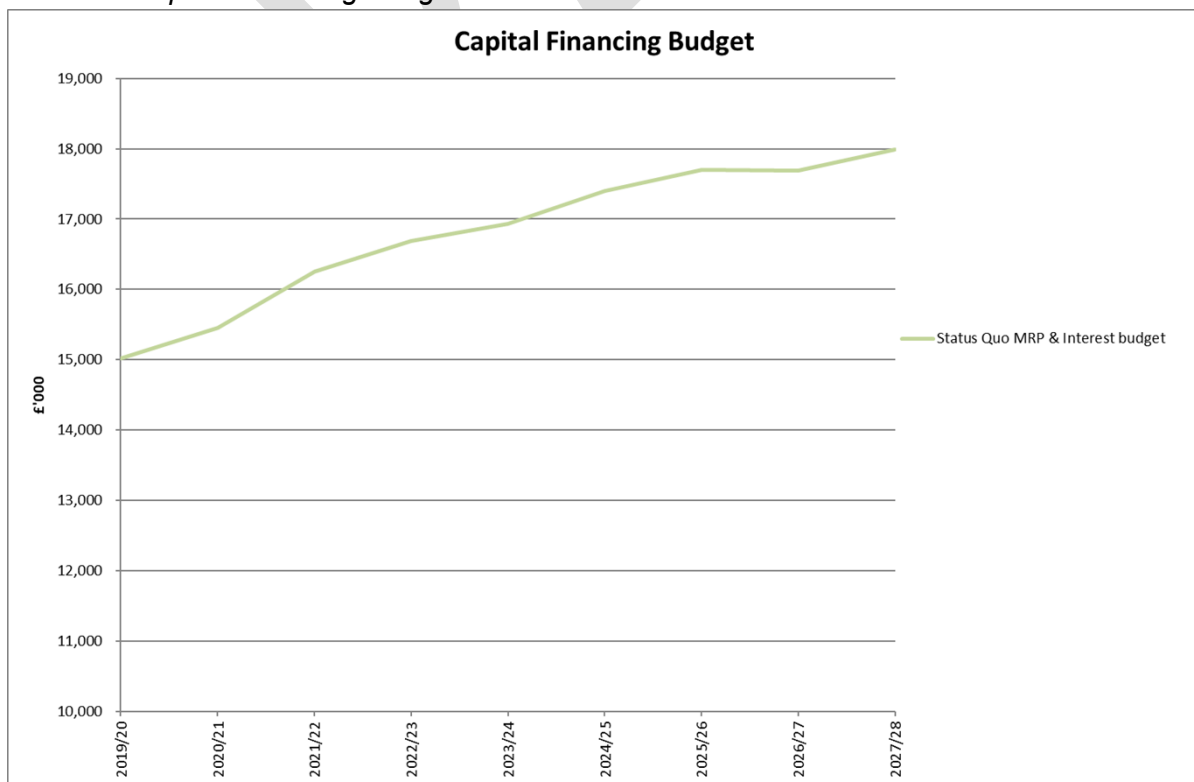
- Current external borrowing requirement coming from the capital programme and bringing forward a limited amount of early borrowing to replace internal borrowing where appropriate
- Ability to undertake borrowing for onward loans to third parties for regeneration purposes (subject to strict due diligence)

- Flexibility to borrow for investment / income generating / commercialisation opportunities (subject to governance arrangements)

(ii) Long-term challenge - capital financing costs

21. Capital expenditure is often for assets which have a long-term life, therefore the financing of these assets could also be over a long-term period. Because of this, it is important to take a long-term view of capital expenditure plans and the impact that may have on the affordability and sustainability of capital expenditure. Once a decision has been made to fund capital expenditure from borrowing, the Council is locked into the revenue implications for that borrowing for a long - period.
22. When capital expenditure is funded by borrowing, there is a revenue capital financing cost incurred through repayment of borrowing (the MRP) and interest payable. The capital strategy highlights that capital financing costs are forecast to increase over the long-term i.e. the next 10 years. This is illustrated by Chart 1 which highlights the financing costs to 2027/28.
23. Chart 1 shows that by 2027/28, even with no further capital expenditure funded by borrowing in the future programme, the revenue financing cost of borrowing is predicted to rise to above £17m (from £15.0m in 2019/20). This is due to increasing external borrowing from the current capital programme to 2022/23 and resulting interest costs as internal borrowing capacity reduces, plus an increasing MRP. This will be updated periodically as clearly, the chart is based on a number of assumptions, main one's being
- Delivery of the current capital programme – slippage on the current programme phasing will reduce the rate of increase for example.
 - Reserves level – accelerated use of reserves/net reduction in level of reserves from current assumptions will increase the rate of increase for example

Chart 1: Capital Financing Budget 2019/20 to 2027/28



24. The Capital Strategy also outlines the challenge the Council faces over the longer-term and highlights the following:
- the Council will need to re-finance maturing debt over the long-term i.e. the Council is committed to long-term borrowing position
 - internal borrowing is being replaced by external borrowing over time which increase the interest payable
 - increased capital expenditure funded from borrowing immediately requires additional external borrowing, again putting pressure on interest budgets.

Strategic Plans

25. It is a requirement that the capital strategy demonstrates that the Local Authority takes both capital and investments decisions in line with service objectives. The capital strategy shows that the key drivers of the Council’s Capital plans are captured through various plans across the authority. These include;



26. There are key issues coming out of all of these documents, over the long-term we know the Council has a difficult challenge in sustaining and building upon the current assets it has under the current financial climate. The Strategy acknowledges the need to further develop our use of these plans in developing and prioritising the Council’s Capital Programme.
27. Capital investment in service assets is highly constrained by the funding available and therefore has not been funded at a level required to keep these assets in a steady state condition or to address backlog maintenance needs.
28. There is significant backlog maintenance shortfall especially for operational properties, highways assets and schools buildings. The value of annual sums is insufficient to address the backlog maintenance needs, however annual sums included in the capital programme for highways maintenance, relevant specific capital grants and the 21st Century Schools programme will assist in addressing the highest priority backlog issues, focussing on worst condition first and risk. However, estate rationalisation programmes, closure/disposal of assets, asset transfers and other capital projects to refurbish or replace operational properties (i.e. neighbourhood hubs, work on the library, Newport market development) will also be utilised to offset the backlog funding required. This will not address the total backlog, but is a way of targeting the main issues in an affordable manner.

Treasury Management Strategy

29. The Council is involved in two types of treasury activity:

- Borrowing long-term for capital purposes and short term for temporary cash flow
- Investment of surplus cash

30. The borrowing and investment activities are controlled primarily via the Council's Treasury Management Strategy and various measures and limits set via its Prudential Indicators to regulate/control the implementation of that strategy.

31. CIPFA requires local authorities to determine their Treasury Management Strategy Statement (TMSS) and Prudential Indicators (PIs) on an annual basis. This requires approval by full Council following a recommendation from the Cabinet. The TMSS also includes the Annual Investment Strategy (AIS) that is a requirement of the Welsh Government's (WG's) Investment Guidance.

32. Our detailed Treasury strategies for 2020/21 are included at Appendix 3. In addition, planned strategies to 2022/23 are also included, in line with the Council's remaining Medium Term Projections. Key points of interest are summarised below.

Borrowing Strategy

33. The Council has significant long term borrowing requirements but in recent years, the strategy has been able to fund its capital expenditure from reducing investments rather than undertaking more expensive new borrowing i.e. using 'surplus cash', known as 'internal borrowing'. This is because the rates achievable on the Council's investments are lower than the rates that would be payable on long-term borrowing and therefore this strategy is more cost effective. As at 31 March 2019 the Council had a loans borrowing requirement of £237m, and had external borrowing of £193m (£153m excluding very short borrowing for refinancing debt in April 2019), meaning that the Council was internally borrowed (mainly from reserves held) by £84m. To put this in context of the borrowing strategy, if the internal borrowing was replaced by external borrowing at a rate of 3%, this would require additional interest payable budget of c£2.5m.

34. The capacity to undertake further internal borrowing has now ended and there will be requirement to take out external borrowing. In summary the borrowing strategy is as follows:

- Whilst the capacity for further internal borrowing has reached capacity and in 2020/21 the Council is expected to undertake external borrowing both for the refinance of maturing loans and to fund the capital programme, it will remain as much 'internally borrowed' as is possible and increase actual external borrowing only when needed to manage its cash requirements. However, the Council may, where it feels necessary to mitigate the risk of interest rate rises, undertake borrowing early to secure interest rates within agreed revenue budgets, where appropriate and affordable. This will be done in line with advice from our Treasury Advisors
- As existing borrowing matures there will be the need to refinance this debt over the long-term taking into account the maturity profile of existing debts.
- The Council is committed to being a 'net borrower' over a long-term.
- The borrowing limits over the medium term have been set in line with the expected borrowing required. A buffer for the ability to undertake a level of borrowing early, and to borrow for commercialisation or regeneration investment purposes where the business case is approved within governance arrangements.

- The need to borrow is increasing over time, meaning that the Council will be required to undertake new borrowing over time, therefore putting pressure on the revenue budget through increased interest payments.
 - Authority may borrow short-term loans to cover unplanned cash flow shortages.
35. In terms of the revenue budget, the Council must ensure it sets aside sums to repay capital expenditure funded from borrowing (irrespective of whether the borrowing itself is undertaken externally or through dis-investing). This is done via the 'Minimum Revenue Provision' (MRP). In addition, a budget is also needed to fund actual interest payable on loans taken out, which are based on predictions of actual external borrowing. Both are discrete budget lines in the Council's overall revenue budget.
36. Local Authorities measure their underlying need for long-term borrowing. This is detailed in tables 1 and 2 of Appendix 3 and highlights the following:
- The need to take out new borrowing is predicted to be £61 million over the next four years.
 - This is broken down into £18.1m of re-financing existing borrowing and £43m new borrowing to replace internal borrowing and to fund new capital expenditure. This latter amount will be dependent on progress in delivering/spending our current capital programme and the Council's reserves position.
37. The authority will adopt a flexible approach to any borrowing necessary in consultation with its treasury management advisers, Arlingclose Ltd. The following issues will be considered prior to undertaking any external borrowing:
- Affordability
 - Maturity profile of existing debt
 - Interest rate and refinancing risk
 - Borrowing source

Investment Strategy

38. The authority has held invested funds over the year, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the authority's investment balance has ranged between £14.5 million and £69.0 million, the large balance being when the Council undertook borrowing early in respect of refinancing maturing debt in April 2019 of £40m. In 2020/21, the level of investment is likely to remain between £10 million and £20 million, due to the continuation of the second Markets in Financial Instruments Directive (MiFIDII), where the authority will be required to maintain a minimum investment balance of £10 million. Whilst this puts a limit to the extent the Council can be internally borrowed, it is a relatively small balance in the wider scheme of the Councils cash-flows and borrowing and the strategy of keeping external borrowing to the minimum possible level still stands.
39. **Objectives:** Both the CIPFA Code and the WG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses.
40. Given the increasing risk and continued low returns from short-term unsecured bank investments, the Authority aims to diversify into more secure and/or higher yielding classes during 2020/21, this is likely to include investing in pooled funds if the accounting arrangements are suitable.

41. **Approved Counterparties:** Whilst investment funds remain available and based on the treasury management advice from Arlingclose; the Authority may invest its surplus funds with any of the counterparty types in table 4 of Appendix 3.
42. A more detailed explanation of the different approved counterparty types is included in Appendix 3 but for the sake of clarity, the Council's investment strategy will, as per the Welsh Governments Investment Guidance, give priority to security and liquidity and will aim to achieve a yield commensurate with these principles.
43. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.
44. Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to diversify into higher yielding asset classes during 2020/21. This is especially the case for the estimated £10 million that is available for longer-term investment. All of the Authority's surplus cash is currently invested in short-term unsecured bank deposits and local authorities. This diversification will represent a change in strategy over the coming year.

Minimum Revenue Provision (MRP) Policy

45. The MRP Policy is detailed in Appendix 3d and remains unchanged.

Treasury Management Indicators

46. Council are required to approve the 2020/21 Treasury Management Strategy and Treasury Management Indicators detailed in Appendix 3.
47. Prudential Indicators that were previously included within the treasury management strategy have been moved to the capital strategy as these are better placed within that document.

Risks

Risk	Impact of risk if it occurs* (H/M/L)	Probability of risk occurring (H/M/L)	What is the Council doing or what has it done to avoid the risk or reduce its effect	Who is responsible for dealing with the risk?
Capital Expenditure increases need to borrow	H	M	Regular monitoring and reporting of available headroom should identify any issues at an early stage and keep Cabinet / Council updated	
Investment counterparty not repaying investments	High but depending on investment value	Low	The Council only invests with Institutions with very high credit scores. It employs advisors to monitor money market movements and changes to credit scores and acts immediately should things change adversely. The lower	Members, Head of Finance, Treasury staff, based on advice from treasury advisors

			levels of funds/duration available for relatively higher risk investment as measured by 'credit ratings' will also alleviate the risk.	
Interest Rates moving adversely against expectations	Low	Low	Base and short-term Interest rates are expected to remain at current levels until. The Treasury strategy approved allows for the use of short term borrowing once investment funds are exhausted to take advantage of these low rates.	Head of Finance, Treasury staff, treasury advisors

Links to Council Policies and Priorities

The Capital strategy sets out the Capital Programme over a long term context and demonstrates that the Capital Programme supports a number of the Council's aims and objectives.

It is the Council's policy to ensure that the security of the capital sums invested is fully recognised and has absolute priority. The Council follows the advice of the Welsh Assembly Government that any investment decisions take account of security, liquidity and yield in that order.

Options Available and considered

To provide comment both the Capital Strategy and the Treasury Management Strategy and the recommendations within, and approve the capital programme.

Preferred Option and Why

To provide comment the updated 2018/19-2024/25 capital programme. The Prudential Code 2017 places a requirement on Local Authorities to determine a long term Capital Strategy. The Prudential Code and statute also requires that, before the end of the financial year, reports on Treasury Management matters are presented to Cabinet/Council for approval. Therefore, Cabinet are required to endorse both the Capital Strategy and the Treasury Management Strategy to Council and approve the capital programme.

Comments of Chief Financial Officer

Both the Treasury Management and Capital Strategy highlight the revenue implications from capital expenditure, and for the need for the capital plans of the authority to be affordable, prudent and sustainable.

A framework has been approved which sets out how the Council will maximise its capital expenditure while staying within an affordability headroom. This 'headroom' provides a degree of flexibility for further projects to be added to the programme within the current capital financing budgets included over the life of the MTFP. A decision could be made to increase this headroom, but this would create a greater pressure on the MTFP, which in the current financial climate may not be affordable.

Over the long-term a view has to be taken on the programme to reflect the increasing capital financing costs and the need to restrict capital expenditure funded by borrowing to a minimum based on risk and prioritisation.

The treasury management strategy highlights that the borrowing strategy has changed on previous years due to the capacity for further internal borrowing being diminished. The Council now will need to undertake external borrowing, and will take a view on whether this can be done early to mitigate the risks of interest rate rises and remain within current set budgets.

Comments of Monitoring Officer

There are no legal implications. The in-year and annual treasury management report is consistent with relevant Chartered Institute of Public Finance and Accountancy Guidance, Treasury Management principles and the Council's Investment Strategy.

Comments of Head of People and Business Change

There are no human resources implications within the report

Comments of Cabinet Member

N/A

Local issues

N/A

Scrutiny Committees

N/A

Equalities Impact Assessment and the Equalities Act 2010

The Equality Act 2010 contains a Public Sector Equality Duty which came into force on 06 April 2011. The Act identifies a number of 'protected characteristics', namely age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex; sexual orientation; marriage and civil partnership. The new single duty aims to integrate consideration of equality and good relations into the regular business of public authorities. Compliance with the duty is a legal obligation and is intended to result in better informed decision-making and policy development and services that are more effective for users. In exercising its functions, the Council must have due regard to the need to: eliminate unlawful discrimination, harassment, victimisation and other conduct that is prohibited by the Act; advance equality of opportunity between persons who share a protected characteristic and those who do not; and foster good relations between persons who share a protected characteristic and those who do not. The Act is not overly prescriptive about the approach a public authority should take to ensure due regard, although it does set out that due regard to advancing equality involves: removing or minimising disadvantages suffered by people due to their protected characteristics; taking steps to meet the needs of people from protected groups where these differ from the need of other people; and encouraging people from protected groups to participate in public life or in other activities where their participation is disproportionately low.

Children and Families (Wales) Measure

N/A

Wellbeing of Future Generations (Wales) Act 2015

The Wellbeing of Future Generations (Wales) Act 2015 is taken into account when looking at the long-term impact of treasury management and capital decisions. The Council has a prudent Minimum Revenue Provision Policy and abides by the treasury management and prudential indicators detailed in the report. An effective capital strategy will enable the Council to support long term planning in line with the sustainable development principle of the Act.

Crime and Disorder Act 1998

Section 17(1) of the Crime and Disorder Act 1998 imposes a duty on the Local Authority to exercise its various functions with due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent, crime and disorder in its area.

Consultation

N/A

Background Papers

Report on Treasury Management for the period to 30 September 2018
Capital Monitoring and Additions Report

Dated:

DRAFT

Appendix 1 – Current Capital Programme

	Outturn 18/19	Budget 19/20	Budget 20/21	Budget 21/22	Budget 22/23	Budget 23/24	Budget 24/25	Total
21 st Century Schools - Band A	8,046	1,451	-	-	-	-	-	9,497
21 st Century Schools - Band B	675	2,229	14,817	31,791	10,557	7,940	2,349	70,358
Jubilee Park - Fixtures, Furniture & Equipment	13	-	-	-	-	-	-	13
Gaer Annexe Education Use	-	495	-	-	-	-	-	495
Pentrepoeth - IT Replacement	-	7	-	-	-	-	-	7
Blaen-y-Pant Bungalow (Educational Use)	52	8	-	-	-	-	-	60
St Mary's Toilet Refurbishment.	-	42	-	-	-	-	-	42
Somerton Primary - ICT Equipment	11	-	-	-	-	-	-	11
Feminine hygiene hardware & toilet facilities.	34	-	-	-	-	-	-	34
Lliswerry High (S106 Funds)	110	62	-	-	-	-	-	172
Maesglas Reducing classroom size	-	142	378	-	-	-	-	520
Lliswerry IT Replacements	53	-	-	-	-	-	-	53
Welsh Medium Primary School	-	335	865	1,300	1,000	2,300	-	5,800
Reducing Classroom size bids	-	85	495	-	-	-	-	580
Bassleg Demountables	-	206	-	-	-	-	-	206
ICT Equipment Lease (Clytha Primary)	-	21	-	-	-	-	-	21
ICT Equipment Lease (St Mary's)	-	12	-	-	-	-	-	12
St Patricks ICT	-	12	-	-	-	-	-	12
Bassaleg ICT	-	83	-	-	-	-	-	83
Ringland Perimeter Fence	-	86	-	-	-	-	-	86
Llanmartin Primary ICT	10	-	-	-	-	-	-	10
Malpas Park Primary	11	-	-	-	-	-	-	11
Education Maintenance Grant	-	1,828	-	-	-	-	-	1,828
Education Asset Improvements - balance to be drawn down	1,055	207	-	-	-	-	-	1,262
Prior Year Scheme - Various	(38)	-	-	-	-	-	-	(38)
Education	10,032	7,311	16,555	33,091	11,557	10,240	2,349	91,135
Gypsy/Traveller Site Development	2,993	143	-	-	-	-	-	3,136
Indoor Newport Market	-	-	4,000	-	(4,000)	-	-	-

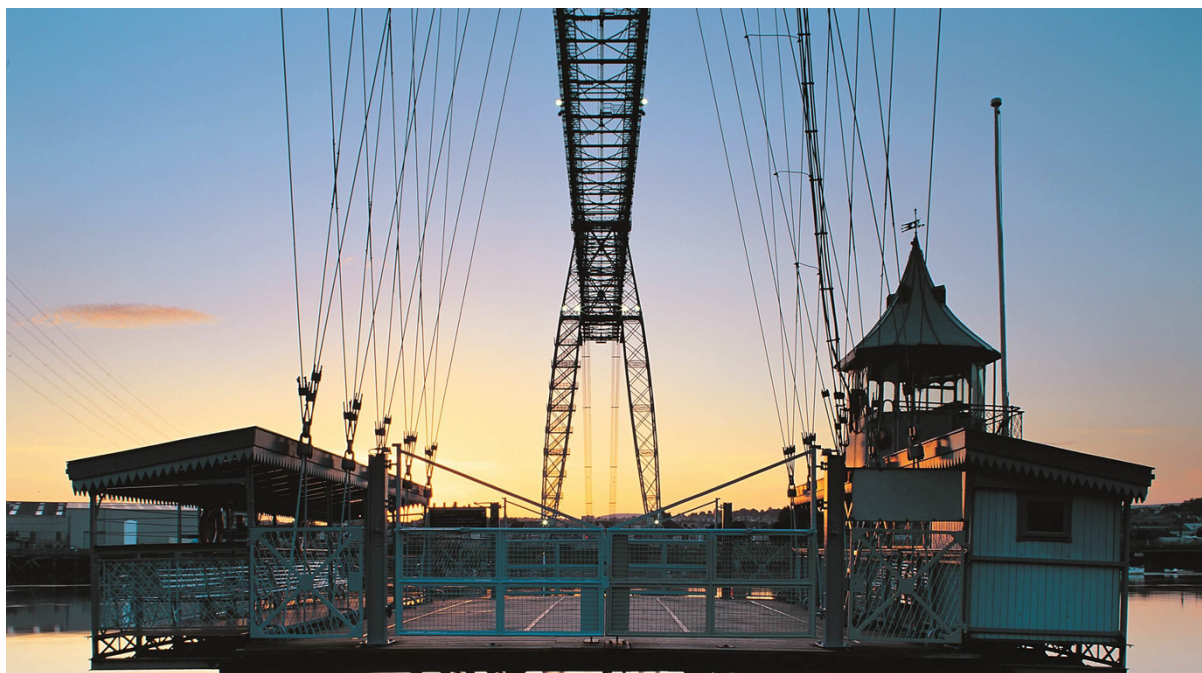
HLF Market Arcade Townscape Heritage Scheme	39	350	1,472	980	-	-	-	2,841
Indoor Market Facilities Improvements	(2)	-	-	-	-	-	-	(2)
Civic Centre / Info Station Service Relocations	116	150	-	-	-	-	-	266
Info Station NSA enabling	536	-	-	-	-	-	-	536
123-129 Commercial Street (Pobl Regen)	623	623	-	-	-	-	-	1,246
Cardiff City Region Deal	1,208	496	1,026	782	782	1,277	-	5,571
Mill Street Development Loan	-	4,000	-	-	-	-	-	4,000
Neighbourhood Hubs	915	1,430	-	-	-	-	-	2,345
Arva Investment Loan	385	365	-	-	-	-	-	750
Disabled Facilities	898	1,256	1,000	1,000	1,000	-	-	5,154
Safety at Home	364	282	300	300	300	-	-	1,546
ENABLE Adaptations Grant	197	197	-	-	-	-	-	394
Homelessness Prevention Grant	98	-	-	-	-	-	-	98
Asset Management Programme	1,066	2,156	1,728	1,500	1,500	-	-	7,950
FS Maintenance 1819 / 1920	31	40	-	-	-	-	-	71
FS Shaftsbury Community Centre	183	-	-	-	-	-	-	183
Childcare - Flying Start	-	704	1,764	-	-	-	-	2,468
Central Library - Structural Works	72	100	491	-	-	-	-	663
Transporter Bridge	72	967	5,559	6,339	-	-	-	12,937
Chartist Tower	-	1,600	-	-	-	-	-	1,600
PAC System	-	59	-	-	-	-	-	59
OLEV Residential EV charging Equipment	-	134	-	-	-	-	-	134
Medieval Ship	-	-	-	12	-	-	-	12
Renewable Energy Investment	-	20	1,709	-	-	-	-	1,729
Prior Year Scheme - Various	(7)	-	-	-	-	-	-	(7)
Regeneration, Investment and Housing	9,787	15,070	19,049	10,913	(418)	1,277	-	55,680
IT Replacement Schemes	94	80	443	150	150	-	-	917
Corporate EDMS Rollout	-	13	-	-	-	-	-	13
CRM	250	334	186	-	-	-	-	770
Print 2010- Managed Printer Service	131	249	-	-	-	-	-	380
People and Business Change	475	676	629	150	150	-	-	2,080

Telecare Service Equipment	97	54	30	30	30	-	-	241
Equipment for Disabled Grant (GWICES)	165	165	165	165	165	-	-	825
Home Care System	32	-	-	-	-	-	-	32
Centrica Lodge	(6)	-	-	-	-	-	-	(6)
SMAPF	320	-	-	-	-	-	-	320
Adults and Community Services	608	219	195	195	195	-	-	1,412
3 New Homes	701	1,421	-	-	-	-	-	2,122
Oaklands Respite Home	505	35	-	-	-	-	-	540
Windmill Feasibility Study	41	110	1,390	-	-	-	-	1,541
Children's and Families Services	1,247	1,566	1,390	-	-	-	-	4,203
Fleet Replacement Programme	797	2,500	2,545	448	1,850	-	-	8,140
Bus station - Friars Walk Development	29	88	-	-	-	-	-	117
Flood Risk Regulation Grant	24	67	-	-	-	-	-	91
Cemetery Infrastructure Improvements	16	40	82	-	-	-	-	138
Peterstone Sewage Scheme	1	21	201	-	-	-	-	223
Road Safety Capital 2018/19	-	1,409	600	-	-	-	-	2,009
Composting	567	10	-	-	-	-	-	577
Docksway Cell 4 Development	1,555	601	-	-	-	-	-	2,156
CCTV	-	45	-	-	-	-	-	45
Smaller Bins - MTRP BC	70	1,180	-	-	-	-	-	1,250
Newport Station Footbridge - LTF	77	267	2,775	-	-	-	-	3,119
Decriminalised Parking	232	1,154	-	-	-	-	-	1,386
Update Facilities in Parks	18	38	-	-	-	-	-	56
Decommissioning of Cemetery Office & Toilets	11	-	-	-	-	-	-	11
Building Improvements to Lodges	14	66	-	-	-	-	-	80
Small Scale Works Grant	34	-	-	-	-	-	-	34
Road Refurbishment Grant Scheme	931	107	-	-	-	-	-	1,038
Street Lighting LEDs	564	2,501	-	-	-	-	-	3,065
Local Transport Fund - Active Travel Northern 2018/19	290	310	-	-	-	-	-	600
Tredegar Park Car Park	-	12	-	-	-	-	-	12
Tredegar Park - Pedal Power	-	120	35	35	35	-	-	225

Lliswerry Road (81)	-	12	-	-	-	-	-	12
28-30 Stow Hill (11/0269)	-	7	-	-	-	-	-	7
Forbisher Road (15/0720)	-	27	-	-	-	-	-	27
Festive lighting	-	107	-	-	-	-	-	107
Local Transport Fund - Active Travel Design 2018/19	240	-	-	-	-	-	-	240
Bus Stop Enhancements	-	400	-	-	-	-	-	400
Core AFT Allocation	-	340	-	-	-	-	-	340
Inner City Links	-	890	-	-	-	-	-	890
LTNF - ECO Stars	42	50	-	-	-	-	-	92
Safe Routes - St Davids RC Primary	84	205	-	-	-	-	-	289
Gwastad Mawr Flood Attenuation Improvement Works	2	41	-	-	-	-	-	43
18-19 Collection Collaborative Change Programme	1,175	-	-	-	-	-	-	1,175
LTF Monkey Island Bridge Lliswerry Pill	29	168	-	-	-	-	-	197
LTF Sustainable Transport	25	300	-	-	-	-	-	325
Riverside Park	20	38	-	-	-	-	-	58
Pye Corner Railway Station Development Works	21	-	-	-	-	-	-	21
Nappy Grant	-	202	-	-	-	-	-	202
Park Square Lights	-	60	-	-	-	-	-	60
Velodrome Lights	-	173	-	-	-	-	-	173
Road Safety and Training	455	20	20	20	20	-	-	535
General Traffic Management	-	30	30	30	30	-	-	120
Streetwide Improvements	-	200	200	200	200	-	-	800
Street Lighting Column Replacement	-	331	250	250	250	-	-	1,081
Lliswerry Recreation Ground Changing Rooms	4	339	-	-	-	-	-	343
Prior Year Scheme - Various	(11)	3	-	-	-	-	-	(8)
City Services	7,316	14,479	6,738	983	2,385	-	-	31,901
Total	29,465	39,321	44,556	45,331	13,869	11,517	2,349	186,408
Financed By:								
General Capital Grant	4,754	3,858	2,469	2,469	2,000	2,000	822	18,372
Supported Borrowing	4,058	4,077	4,058	4,058	4,000	2,057	-	22,308
Unsupported Borrowing	1,740	11,349	10,635	10,305	(616)	-	-	33,413

Prudential Borrowing	84	128	-	-	-	-	-	212
External Grants	13,296	12,244	23,941	28,082	7,862	7,461	1,527	94,413
S106	868	799	35	35	35	-	-	1,772
Other Contributions	242	-	237	232	-	-	-	711
Capital Receipts	3,136	3,290	2,504	-	588	-	-	9,518
Revenue Contributions	75	203	-	-	-	-	-	278
Reserve	1,081	3,124	677	150	-	-	-	5,032
Finance Lease	131	249	-	-	-	-	-	380
Total	29,465	39,321	44,556	45,331	13,869	11,517	2,349	186,408

DRAFT



NEWPORT CITY COUNCIL
CAPITAL STRATEGY
2019/20 TO 2028/29



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EXECUTIVE SUMMARY

This Capital Strategy is an update on the first strategy approved last year and sets out the long-term view of the affordability, sustainability and prudence of the capital programme and the implications on the revenue budgets.

The capital strategy is inherently linked to the treasury management strategy and the borrowing and investment decisions it takes. Full Council are required to approve the capital strategy and the prudential indicators within.

It highlights that in the current climate of financial constraints and a Medium Term Financial Projection (MTFP) budget gap, that expenditure on capital needs to remain within affordable limits. Demand for capital resources remain high and therefore inevitably, prioritisation of projects, leveraging in other sources of funding and working with partners are required to meet this demand.

The strategy highlights the key risks and recommendations:

- Capital expenditure plans for the Council need to be affordable, prudent and sustainable.
- The MTFP includes the revenue costs for the financing of the current capital programme to 2022/23, which includes a level of headroom for additional capital projects to be added without impacting further on the revenue budget.
- As per the agreed framework (detailed in the report) the current programme needs to be maintained within the affordability headroom, therefore not putting additional pressure on the MRP budget.
- Within the context of significant demands for capital resources and limited availability, there is the need to develop our use of the various strategic plans across the organisation which drive the need for capital and develop alternative strategies to meet demand so the Councils own capital programme is prioritised within an affordable framework. This will include clearer and corporate visibility and assessment of demand for schools, highways and other operational assets.
- Decisions on funding capital expenditure through borrowing locks the Council into committing revenue funding over a very long period (as long as 40 years+). With the MRP budget increasing over the long-term, the Council will need to make some difficult decisions going into the next programme to ensure the capital plans remain affordable and sustainable.
- The prudential indicators, including borrowing limits, are in line with the MTFP approved by Cabinet.

The strategy will be reviewed and updated on an annual basis alongside the Treasury Management Strategy.

1. OVERVIEW OF THE STRATEGY

1.1. INTRODUCTION

The prudential code for Capital Finance in Local Authorities (2017) placed a requirement on local authorities to determine a Capital Strategy in order to demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability.

This capital strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. It has been written in an accessible style to enhance members' understanding of these sometimes technical areas.

Decisions made this year on capital and treasury management will have financial consequences for the Authority for many years into the future. They are therefore subject to both a national regulatory framework and to local policy framework, summarised in this report.

The report sets out:

- The prudential code the need for a capital strategy and the governance arrangements for the capital strategy and programme (Paragraph 2)
- The current approved capital programme to 2024/25 (5 years) and its financing, and the revenue implications arising from demands on capital expenditure (Paragraph 3)
- The long-term (10 year) projection for the capital financing costs of the Council and where future demands arise from the various strategic plans across the authority for further capital resources. (Paragraph 4)
- Links between the Capital Strategy to Treasury Management strategy and treasury decision making. (Paragraph 5)
- A look at the commercial activity of the Council and its strategy going forward (Paragraph 6)
- Overview of other long-term liabilities the Council has, which members need to be aware of when looking at the capital strategy. (Paragraph 7)
- Summary of the skills and knowledge the Council has to carry out its duties for capital and treasury matters. (Paragraph 8)

2. PRUDENTIAL CODE & GOVERNANCE

2.1. PRUDENTIAL CODE – KEY OBJECTIVES

The objective of the Prudential Code is to ensure, within a clear framework, that the capital expenditure plans of local authorities are;

- **AFFORDABLE** - Total capital investment of the authority remains within sustainable limits. A local authority is required to consider the resources currently available to it and those estimated to be available in the future, together with the totality of its capital plans and income and expenditure forecasts in assessing affordability.

- **PRUDENT** – The full Council set an authorised limit and operational boundary for external debt, these need to be consistent with the authority’s plans for affordable capital expenditure and financing, and with its treasury management policy statement and practices. Authorities should consider a balance between **security, liquidity and yield** which reflects their own risk appetite but which prioritises security and liquidity over yield.
- **SUSTAINABLE** – taking into account the arrangements for repayment of debt (including through Minimum Revenue Provision (MRP) and consideration of risk and the impact, and potential impact, on the authority’s overall financial sustainability. This strategy will look at the sustainability over the period of 10 years.

and treasury management decisions are taken in accordance with good professional practice and in full understanding of the risks involved and how these risks will be managed to levels that are acceptable to the organisation.

2.2. GOVERNANCE FOR APPROVAL AND MONITORING OF CAPITAL EXPENDITURE

Member responsibility for assets rests with a cabinet member, currently the **cabinet member for assets and member development (Deputy Leader)**. The main governance and approval process for capital expenditure is summarised as follows:

- Council approve the overall revenue and capital budgets following recommendations from the Cabinet. They also approve the borrowing limits of which the capital programme will need to remain within. These limits are a key performance indicator for treasury management. This ensures that capital expenditure and borrowing remains within an affordable limit.
- This borrowing limit drives the headroom available for Capital Expenditure to be included on the programme.
- Council approve the Treasury Management and Investment strategies, which are intrinsically linked to capital expenditure and the capital strategy. Further details of these are provided in paragraphs **5.1** and **5.3**.
- The detailed capital programme within the overall budget is approved by Cabinet following individual project appraisals by officers, containing the views of the Head of Finance.
- Items of capital nature, are discussed at the Capital Strategy Asset Management Group (CSAMG), which is made up of senior officers from all service areas and our property advisors, Newport Norse. Discussions include asset disposals, where capital expenditure is required and prioritisation of those areas and the overall asset management agenda.
- Decisions on Capital Expenditure will be made by the Senior Leadership Team (SLT) following review of the project appraisal.
- Cabinet approve capital expenditure to be added to the capital programme.
- Monitoring of Capital Expenditure is reported to Cabinet, and includes update on capital receipts and impact on the revenue budget of decisions made.

Affordability and sustainability is a key focus on the approval of expenditure, and therefore the agreed framework detailed in paragraph **3.1** is used. There is a process map for the approval of capital expenditure which is used, this is shown in Appendix **2a**.

Decisions made on the approval of capital expenditure will be made with the liaison of the capital accountancy team and understanding of the long-term revenue implications of the expenditure is assessed

before being added to the programme. Cabinet approve additions and deletions, as well as slippage, from the capital programme alongside the monitoring report.

3. CAPITAL EXPENDITURE AND FINANCING

Capital expenditure is where the Council spends money on assets, such as property or vehicles that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. It is the Councils policy not to treat any expenditure under £10,000 as capital, and therefore under this value will be charged as revenue in the year of expenditure.

3.1. CURRENT CAPITAL PROGRAMME

The current capital programme was recently extended to 7 years to reflect projects whose completion spanned beyond the original 5 year programme, taking the total programme from 2018/19 to 2024/25, this was approved at the most recent Cabinet in January 2020. As part of the approval, a 'borrowing headroom' was agreed. This headroom enables further capital projects to be added to the programme over the next 5 years, and not put additional pressure on the revenue budget over the Medium Term Financial Projection (MTFP).

Given the current financial constraints facing the authority, Cabinet and Council established a framework in order to maximise capital expenditure but keep within a sustainable revenue budget to fund new borrowing, this was as follows:

- a. Funding from sources other than borrowing needs to be maximised, by securing grant funding whenever possible and, maximising capital receipts
- b. Regeneration schemes would be funded from ring-fencing the capital works reserve only and Joint Venture funds. Other kinds of support through the making of loans etc. would then be considered to support schemes, where it was needed and appropriate.
- c. Any change and efficiency schemes or schemes which save money requiring capital expenditure would be funded by netting off the capital funding costs from the savings achieved
- d. Schemes and projects which generate new sources of income would need to fund any capital expenditure associated with those schemes.

This framework ensures that the capital programme can be maximised but those schemes which cannot fund any resulting borrowing costs e.g. new schools programme, can be afforded and maximised within the headroom available. The headroom is made up of identified uncommitted capital reserves and capital receipts, an estimated level of borrowing which is within the MRP budget and a prudent estimate of future capital receipts

The latest capital programme is summarised in the table below. For 2020/21, the Council has approved capital schemes of £44.6m and there is remaining headroom of £15.7m (subject to budget decisions at Cabinet):

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

	7-YEAR CAPITAL PROGRAMME							Total 7-year programme £m
	2018/19 actual £m	2019/20 forecast £m	2020/21 budget £m	2021/22 budget £m	2022/23 Budget £m	2023/24 Budget £m	2024/25 Budget £m	
Approved Schemes (Appendix 1)	29.5	39.3	44.6	45.3	13.9	11.5	2.3	186.4
Uncommitted headroom to invest in council assets / regeneration*		1.0	4.9	4.9	4.9			15.7
TOTAL EXPENDITURE	29.5	40.3	49.5	50.2	18.8	11.5	2.3	202.1

*split over remaining original 5 year programme, this can be flexed accordingly in line with need.

Paragraph 3.2 illustrates the revenue impact of the capital programme. The framework agrees that the over the term of the current **capital programme would set at a level that does not put additional revenue pressure on the Medium Term Financial Projections (MTFP)**. This is vitally important to maintain capital expenditure at a level that is affordable over the medium term. The headroom that is available allows for additional capital expenditure without increasing the pressures on revenue.

There has been an increase in the general fund capital grant in 2020-21 which has been reflected within the above headroom figures, the future years grant is unconfirmed therefore for prudence it is not assumed that this increase will continue in subsequent years.

The programme has been compiled with regard for the latest demands on the capital programme which include:

- 21st Century Schools Programme – completion of Band A in 2018/19 and Band B from then on.
- Fleet Replacement Programme
- Gypsy & Traveller Site Development
- A number of HLF grant funded schemes including Transporter Bridge and Newport Market Arcade
- Cardiff Capital Region City Deal (CCRCD)
- Neighbourhood Hubs scheme
- Replacement of current street lighting to LED

There are a number of demands on the authority which will require significant capital expenditure which are not yet included on the programme, these will utilise the headroom available. It is important that capital expenditure is maintained at an affordable level within the framework agreed. Therefore, **prioritisation of capital expenditure is essential** and needs to be affordable and sustainable in the long-term to remain within the headroom available.

3.2. MEDIUM-TERM REVENUE IMPLICATIONS OF CAPITAL (CAPITAL FINANCING)

All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). All debt has to be repaid and this includes both the actual debt principal plus interest costs on the debt. The planned financing of the expenditure shown in Table 1 is as follows:

Table 2: Capital financing in £ millions - Current 7-year programme

	7-YEAR CAPITAL PROGRAMME							Total 7-year programme £m
	2018/19 actual £m	2019/20 forecast £m	2020/21 budget £m	2021/22 budget £m	2022/23 Budget £m	2023/24 Budget £m	2024/25 Budget £m	
Committed Grants and contributions	19.2	16.9	26.7	30.8	9.9	9.4	2.3	115.2
Committed Reserves, capital receipts, revenue	4.3	6.6	3.2	0.1	0.6	0	0	14.8
Committed new borrowing	6.0	15.8	14.7	14.4	3.4	2.1	0	56.4
TOTAL COMMITTED (Appendix 1)	29.5	39.3	44.6	45.3	13.9	11.5	2.3	186.4
Uncommitted borrowing headroom*		1.0	2.9	2.9	2.9			9.7
Uncommitted forecast capital receipts/capital grants*		0	1.6	0	0			1.6
Uncommitted capital reserves*		0	0.4	2.0	2.0			4.4
TOTAL UNCOMMITTED*		1.0	4.9	4.9	4.9			15.7
TOTAL FINANCING	29.5	40.3	49.5	50.2	18.8	11.5	2.4	202.1

When capital expenditure is financed by debt/borrowing, you are essentially locking the Council into a long-term revenue commitment. The Council is required to repay debt from our revenue budget over time; this is done through the Minimum Revenue Provision (MRP). Planned MRP payments (excluding PFI and leases) are as follows:

Table 3: Replacement of debt finance (MRP) in £ millions

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget
MRP budget	7.8	7.9	8.8	9.3	9.3

The table above shows the budgeted amount of MRP that is included within the MTFP, the amount is increasing on annual basis, and this will continue to do so over the longer term due to the MRP charge increasing. This shows an increasing pressure over the MTFP while there is still a funding gap, which emphasises the importance of maintaining capital expenditure within the headroom available in order not to put even more additional pressure on the revenue budget.

- The Council's full minimum revenue provision statement is available within the Treasury Strategy which will be approved alongside this capital strategy

Although capital expenditure is not charged directly to the revenue budget, as discussed above, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable - the net

annual charge is known as 'financing costs'. The table below shows the financing costs as a percentage of the Council's net budget, which is one of the Councils Prudential Indicators.

Table 4: Prudential Indicator: Proportion of financing costs to net revenue stream

	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget
Financing costs* (£m)	22.1	22.5	23.2	23.9
Proportion of net revenue stream	7.7%	7.5%	7.6%	7.7%

*includes capital financing costs of PFIs

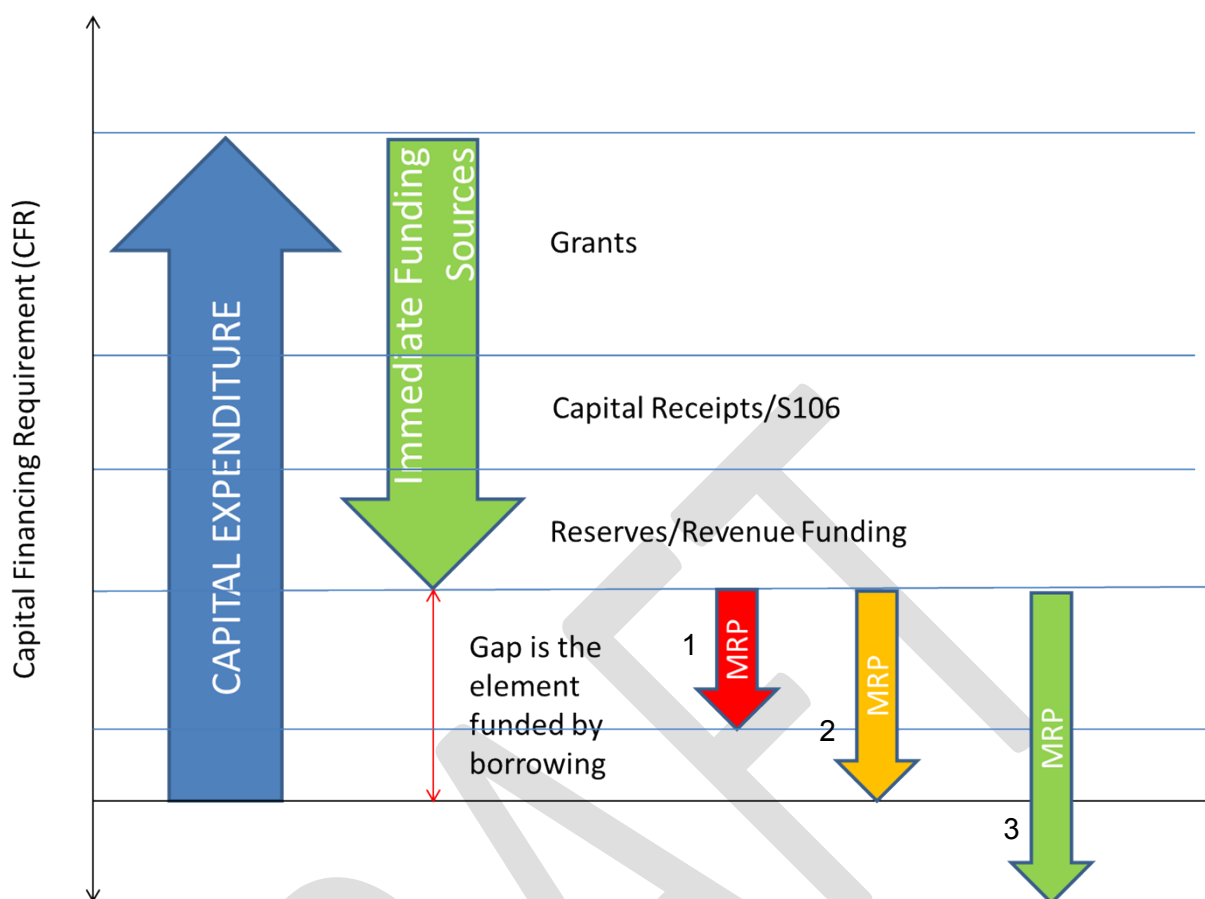
The ability to fund capital expenditure through internal borrowing is no longer applicable due to reserves being utilised, therefore this will need to be externally borrowed. External (or actual) borrowing will have interest rates payable on them which leads to increase in financing costs.

From the table above it is evident that the proportion of the budget set aside to finance capital expenditure is due to increase over the life of the current programme, again reiterating the pressure that capital expenditure, funded from debt, puts on the revenue budget.

- Further details on the revenue implications of capital expenditure are included in the 2020/21 revenue budget report.

Capital Financing Requirement (Our need to borrow)

The Council's cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The diagram below shows the impact of capital expenditure, financing and the MRP on the CFR:



The diagram above shows the following:

1. CFR **increases** when capital expenditure is incurred.
2. CFR **decreases** when capital expenditure is immediately financed i.e. through grants, capital receipts, revenue funding, reserves, S106 income.
3. If the MRP charge is **less than** capital expenditure funded by borrowing (Red [1]) the net CFR increases
4. If the MRP charge is **equal to** the capital expenditure funded by borrowing (Amber [2]) then net CFR stays the same
5. If the MRP charge is **more than** the capital expenditure funded by borrowing (Green [3]) then net CFR decreases

This is an important concept, as it shows how decisions on the level of capital expenditure and the level of MRP budget has on our long-term borrowing and the capital financing implications of this.

The CFR is expected to increase by £7m during 2020/21. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 5: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

	31.3.2019 actual	31.3.2020 forecast	31.3.2021 budget	31.3.2022 budget	31.3.2023 budget
TOTAL CFR	280.0	287.0	292.7	298.2	290.6

The greater the CFR the larger the impact will be on the revenue budget, therefore in the long-term there will be a need to keep capital expenditure funded by borrowing at a level below the MRP budget in order to maintain the revenue budget at a sustainable level.

- For full details of the Council’s capital programme are included in the Capital Additions and Monitoring Report to Cabinet February 2020.

4. LONG-TERM VIEW OF CAPITAL EXPENDITURE

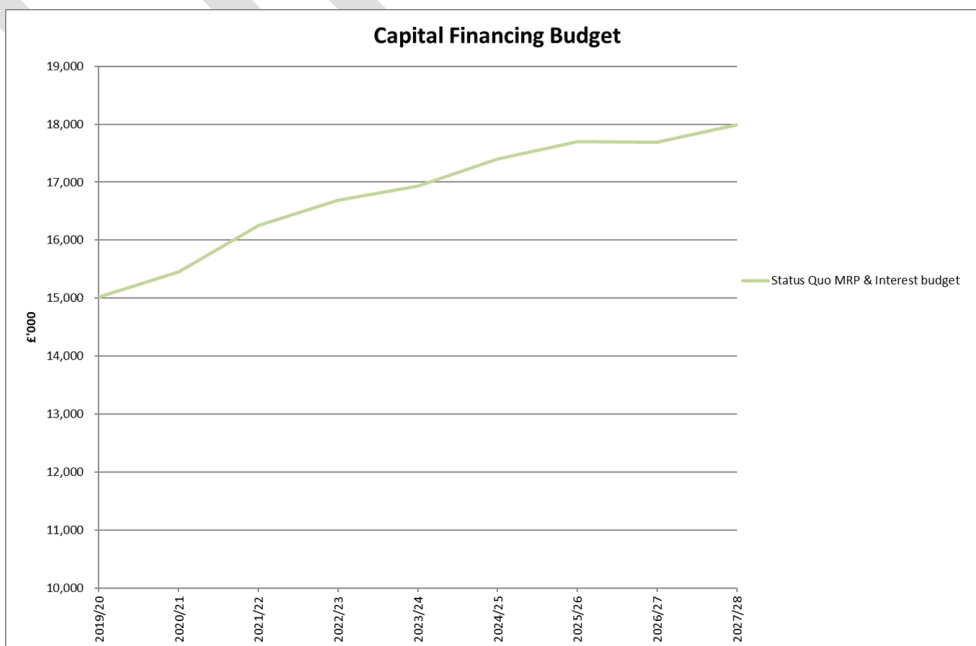
Expenditure on capital assets/projects are often for assets which have a long-term life i.e. buildings may have an asset life of 40 years+. The financing of these assets could also be over a long-term period. Therefore, as well as the Capital Programme highlighted in paragraph 3.1, it is important to take a long-term view of capital expenditure plans and the impact that may have on the affordability and sustainability of capital expenditure. Once a decision has been made to fund capital expenditure from borrowing, the Council is locked into the revenue implications for that borrowing for a long-period.

Due to the financial constraints that the Council is currently facing, assumptions on future available finances are likely to remain tight and therefore over the long-term it is anticipated that revenue to fund capital financing will remain restricted.

Recent changes to the MRP charging methodology and the fact that the capacity to use internal borrowing is reducing means that the authority will face a challenge in developing its next capital programme.

Chart 1 below shows the increasing capital financing costs over the next 10 years. As is evident, based on the current programme the revenue cost of implementing a challenging capital programme is increasing year on year, even with no additional funding from borrowing in future programme. Alongside a revenue budget Medium Term Financial Projection showing a funding gap this provides a significant challenge within current context of funding constraints on Local Government.

Chart 1

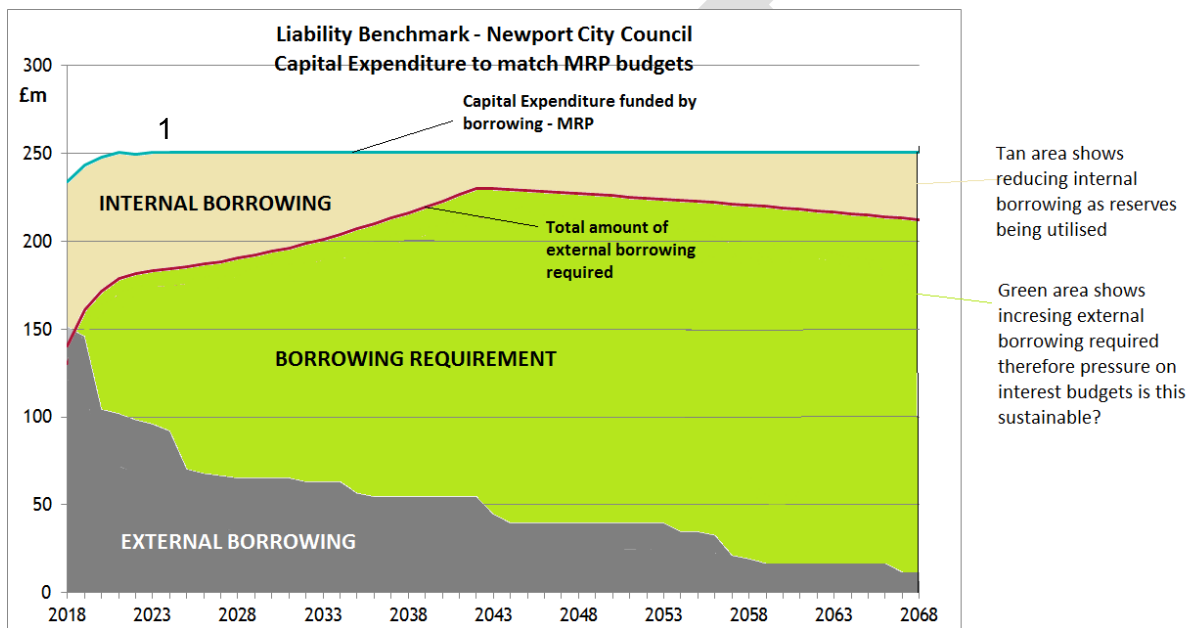


The above will obviously be affected by a number of factors including amount of capital funding from Welsh Government, achievement of capital receipts and use and level of earmarked reserves.

- Earlier in paragraph 3.1 it highlighted the future demands on capital expenditure; the CFR is integral to understanding the affordability and sustainability of the capital programme. If the CFR is increasing over the long-term this puts pressure on the revenue budget to both repay that debt and also on the interest rates to fund the borrowing.

The chart below shows the CFR over the long-term if we were to maintain capital expenditure funded by borrowing at the same value as MRP.

Chart 2



- The chart above illustrates the following:
 - Assumption that capital expenditure funded by borrowing will be at a level equal to the MRP budget (level blue line [1]) – with MRP and interest budgets increasing over time, to remain affordable, capital expenditure funded by borrowing should be no higher than the MRP budget and ideally should be lower to limit the level of external borrowing that is required over time.
 - As earmarked reserves are utilised the amount we are internally borrowed (using our own cash to fund capital expenditure) reduces. We have reached the capacity of internal borrowing, and any further capital expenditure which is not financed at source (i.e. grants, capital receipts, reserves) will require external borrowing.
 - As current external borrowing matures, we will need to re-finance this debt rather than re-pay debt. This is due to the inherent need to borrow over the long-term.
 - The above puts additional pressure on the capital financing budgets through additional interest costs.
 - Therefore, it is vital that the CFR is at a level which is affordable and sustainable.
 - Decisions on future capital programmes and the level of preferred CFR will be made at a time when the next programme is developed.
 - Recent decisions to change the MRP methodology for charging to annuity method for unsupported borrowing and to a 40-year asset life for supported borrowing put future pressures

on the revenue budget without any additional capital expenditure (While over the long-term borrowing is still repaid, the charge today is less and increases over future years). The chart in appendix 2b, shows that the MRP charge with current capital expenditure doesn't decrease significantly until 2030. Therefore, we know that any additional expenditure funded by borrowing will put additional pressure on the revenue budgets in the future.

- Overall this shows a significant challenge for the next capital programme, onwards, and will mean prioritising all forms of capital expenditure in order to keep additional borrowing to a minimum is essential.

➤ Capital Financing costs are discussed further in the Treasury Management section in paragraph 5.

Sustainability

Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The Head of Finance is satisfied that the capital programme is prudent, affordable and sustainable, although there is currently a funding gap in the Medium Term Financial Projections, the increasing capital financing costs and challenges are included within these and plans for closing this gap will need to be put in place by the authority and this is understood by Senior Managers and Members. The next capital programme will be challenging due to the increasing capital financing costs and demands. Therefore, there is the need for prioritisation for the next capital and this will prove a challenge for the Council.

In light of the above, the authority needs to understand the demands and risks associated with the deliverability of meeting these demands. The key drivers of the Council's capital plans are captured through various plans across the authority, these include:



The Authority will need to develop its understanding of the costs arising from each of the above strategic documents, and use these to prioritise restricted funding over the current and future programmes.

Capital investment in service assets is highly constrained by the funding available and therefore has not been funded at a level required to keep these assets in a steady state condition or to address backlog maintenance needs.

This is especially so in relation to highway assets and school buildings. The annual sum required to not only maintain assets at their current standard but to bring the assets to a standard level is significantly above the level that is available.

The plans highlighted above show the significant challenge facing the Authority in coming years and detail backlog maintenance amounts as follows:

- School Buildings - £xm
- Highways Assets - £xm

Annual sums included in the capital programme for highways maintenance, relevant specific capital grants and the 21st Century Schools programme will assist in addressing the highest priority backlog issues, focussing on worst condition first and risk. However, estate rationalisation programmes, closure/disposal of assets, asset transfers and other capital projects to refurbish or replace operational properties (i.e. neighbourhood hubs, work on the library, Newport market development) will also be utilised to offset the backlog funding required. This will not address the total backlog, but is a way of targeting the main issues in an affordable manner.

5. TREASURY MANAGEMENT

5.1. TREASURY MANAGEMENT

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council limits the need to take out actual borrowing by using positive cash-flow, largely from reserves, to fund capital expenditure funded by borrowing, known as internal borrowing.

Due to decisions taken in the past, the Council currently has £151m borrowing at a weighted average interest rate of 3.7% and £13m treasury investments at a weighted average rate of 0.7%.

5.2. BORROWING STRATEGY

Whilst the Council has significant long term borrowing requirements, the Council's current strategy of funding capital expenditure is through reducing investments ('internal borrowing') rather than undertaking new borrowing i.e. we defer taking out new long term borrowing and fund capital expenditure from day to day positive cash-flows for as long as we can.

By using this strategy, the Council can also minimise cash holding at a time when counterparty risk remains high. The interest rates achievable on the Council's investments are also significantly lower than the

current rates payable on long term borrowing and this remains the main reason for our current ‘internally borrowed’ strategy.

Whilst the strategy minimises investment counterparty risk, the risk of interest rate exposure is increased as the current low longer term borrowing rates may rise in the future. The market position is being constantly monitored in order to minimise this risk.

The Council’s main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between cheap short-term loans (currently available at around 0.75%) and long-term fixed rate loans where the future cost is known but higher (currently around 3.0%).

Projected levels of the Council’s total outstanding debt (which comprises borrowing, PFI liabilities, leases are shown below, compared with the capital financing requirement (see above).

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

	31.3.2019 actual	31.3.2020 forecast	31.3.2021 budget	31.3.2022 budget	31.3.2023 budget
Debt (incl. PFI & leases)	236	215	228	237	234
Capital Financing Requirement	280	287	293	298	291

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, the Council expects to comply with this in the medium term.

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

Table 7: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2019/20 limit	2020/21 limit	2021/22 limit	2022/23 limit
Authorised limit – borrowing	230	240	250	245
Authorised limit – PFI and leases	44	43	42	41
Authorised limit – total external debt	274	283	292	286
Operational boundary – borrowing	220	230	240	235
Operational boundary – PFI and leases	44	43	42	41
Operational boundary – total external debt	264	273	282	275

➤ Further details on borrowing are in the treasury management strategy

The above limits look at the following factors and are set providing flexibility for these:

- Current external borrowing values and maturing debts that will require refinancing.
- Ability to undertake borrowing for loans to third parties for regeneration purposes (subject to strict due diligence)
- Flexibility to borrow for commercialisation agenda (subject to governance arrangements)

5.3. INVESTMENT STRATEGY

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

The Council's strategies in this area of Treasury Management are (i) to be a short term and relatively low value investor and (ii) investment priorities should follow the priorities of security, liquidity and yield, in that order.

Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice.

Table 8: Treasury management investments in £millions

	31.3.2019 actual	31.3.2020 forecast	31.3.2021 budget	31.3.2022 budget	31.3.2023 budget
Near-term investments	56	10	0	0	0
Longer-term investments	0	0	10	10	10
TOTAL	24	10	10	10	10

- Further details on treasury investments are in pages 6 to 9 of the treasury management strategy

Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Head of Finance and staff, who must act in line with the treasury management strategy approved by Council. Half-year and end of year reports on treasury management activity are presented Council. The audit committee is responsible for scrutinising treasury management decisions.

Loans to other organisations

The Council can and does make investments to assist local public services, including making loans to businesses to promote economic growth. The Council will assess these opportunities and will only plan that such investments at least break even after all costs. Loans to such organisations will be approved following a due diligence process and formal governance arrangements.

The Council will also use other methods of assisting businesses to promote economic regeneration by providing grants or by allowing rent free periods where the Council is the freehold, such as the case at Chartist Tower.

Decisions on service investments are made by the relevant service manager in consultation with the Head of Finance and monitoring officer and must meet the criteria and limits laid down in the investment strategy. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme.

6. COMMERCIAL ACTIVITIES

6.1. COMMERCIALISATION

In order to help meet the financial challenges faced by the authority Cabinet have approved an initial commercialisation strategy. A link to the report can be found here **XXXXXX**

The proposed strategic objectives of the strategy are set out below:

1. We will target activity to promote social value
2. We will prioritise activities to generate a net profit, which can be used to support core services.
3. Our income generating activities should stimulate economic growth by creating employment.
4. Where appropriate, we will modify methods of service delivery to reduce costs to ensure we take a more commercial approach.
5. We will develop new skills in the organisation to create a modern council

Within these objectives three strands of activity have been identified:

- 1) Current services we could provide on a more commercial basis e.g Trade Waste
- 2) New services we could look to provide e.g energy services
- 3) Property investment – commercial and residential

Establishment of a trading company

A feasibility study will be undertaken on the setting up a trading company through which the commercial activities are managed. This will ultimately seek to support the delivery the first two activities.

Property Investment

In regards to the property investment, an investment board will be created to oversee the delivery of this activity. The investment board will be responsible for the following:

- Ensuring that investment opportunities are thoroughly evaluated, that there is an appropriate balance between risk and reward and that the acquisition contributes to the overall aims of the strategy.
- Approving property investment acquisitions, property management expenditure, property investment disposals and the provision of finance to enable the council to purchase assets.
- Monitoring the progress made in respect of achieving an appropriately balanced and diversified portfolio of assets and its performance.

The Investment Board should prioritise property acquisitions within the Newport City Council municipal boundary but will have authority to invest outside Newport as well. Detailed terms of reference and investment parameters will need to be established for the Board to operate under. These will need developing and approval by Cabinet.

The Investment Board will be a sub set of cabinet and function as a public committee with all the associated governance. The recommended membership is as follows:

Members: Leader
Deputy Leader
Cabinet Members x3

Advisors: Chief Executive
Strategic Director (Place)
Head of Regeneration, Investment & Housing
Head of Law & Regulation (Monitoring Officer)
Head of Finance (Section 151 Officer)
Supported by NORSE as specialist professional advisors

While the parameters are yet to be established. The decision making on this would be based on a number of factors which would take into account potential for returns and risk into account other costs such as interest and Minimum Revenue Provision if financed through borrowing. The priorities for the Council when acquiring property interests for investment purposes are (in order of importance):

- **Covenant Strength**
- **Lease Length**
- **Rate of Return**
- **Risk**
- **Lease Terms**
- **Growth**
- **Location**
- **Sector**
- **Building Age and Specification**

An investment fund of £50m is to be established for the delivery of this activity. This requires the borrowing limits approved by Council to be increased by this value for the purpose of the investment fund. While it is unlikely the full £50m will be required in 20/21, the borrowing limits have included the full £50m in each financial year to allow for the flexibility if required. This is shown in the prudential indicator in table 7 of this report.

Council Assets

The Council also need to continuously assess all of the Council assets to understand what of the Council's assets can and should be making a financial return and maximising those and stop or dispose of them where they are not and is best way forward. To maximise on the Council's financial strength and covenant, and skill is within its workforce and partners where appropriate.

- We will look to use our existing infrastructure for commercial gain and use our land and buildings where we can to deliver housing and growth in such a way as to maximise benefits to the Council
- We will look to share and collaborate with our partners in use of buildings and other assets and generate capital receipts and reduce costs
- We will, through the Councils Treasury Strategy, consider changing our risk appetite for investing in higher return / less liquid assets and recalibrate the cost/benefit of the Councils current practices.
- Implementing this strategy will require, in some areas, financial resources and this will need to be made available via the Councils Invest to Save reserve and where appropriate, prudential borrowing.

This will need to be approved via the governance framework upon business cases meeting assessment criteria, in particular payback period and levels of return.

The Council has an existing investment portfolio, which is 100% based within the city including retail, industrial and office. The Council are currently undertaking a project alongside our property advisors, Norse Newport Ltd, assessing the performance of our Commercial & Industrial portfolio and potential for maximising returns on those assets (which may require up-front investment).

Risk and long-term commitment

Interest rates

- The margins that could be achieved through investing in commercial properties could be relatively low. Due to current low interest rates, it is likely that long-term debt would be the preferred option as the risk of re-financing at a higher rate in the future may take out most, if not, all of any margin. This does however; lock the Council into the commitment of long-term borrowing. This issue would need to be reviewed on a case-by-case basis.

Income generation

- Potential uncertainty in the income generated. These are long-term investments and therefore, the property market will change over that period which could introduce risk to the income being generated and/or value of the investment held. For example, whilst investment could have long term leases associated with them, over the long term, tenants could cease trading or enter into company voluntary arrangements to re-negotiate terms. On the other hand, there is the opportunity that the value of properties and rentals could rise over time also.

Liquidity (How quickly we could sell the property)

- With this type of asset, there is poor liquidity compared to other types of investments, i.e. a relatively long timeframe to sell or change the investment. Therefore if income generation were to fall or the Council wanted to change its direction on investing in commercial properties, it may take a relatively long period to sell the asset, during which the cost of financing the borrowing would continue.

Long-term and fixed cost commitment

- Undertaking investment in commercial properties would significantly increase the Council's long-term debt, therefore any income generated would need to be sufficient to cover the 'capital financing costs' that have been incurred over the long-term i.e. the income has to be sustained over the long-term. If income were to drop, then these costs would still need to be covered.

Asset disposals

As part of the commercial activity, we will look at decisions about our Council assets and this could include disposal. When a capital asset is no longer needed or is not used as an investment opportunity, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. Repayments of capital grants, loans and investments also generate capital receipts. The Council forecasts to receive £0.6m of capital receipts in the coming financial year as follows:

Table 9: Capital receipts in £ millions

	2018/19 actual	2019/20 forecast	2020/21 budget	2020/21 budget	2021/22 budget

Asset sales	2.5	0.6	0	0	0
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7. OTHER LONG-TERM LIABILITIES

In addition to debt of £151m detailed above, the Council has a number of other long-term liabilities (potential call on future Council resources) as follows:

Private Finance Initiative (PFI)

The Council has two PFI arrangements for the provision of the Southern Distributor Road (24 years remaining) and for Glan Usk Primary School (15 years remaining). As at 31 March 2019 the value of the liability was £43.1m. The Council holds an earmarked reserve which covers the future costs of the PFI.

Pension Liability

The Council is committed to making future payments to cover its pension fund deficit (valued at £400.8m).

Provisions and Guarantees

The Council has set aside provisions and reserves for risks in relation to outstanding insurance claims and guaranteed subsidies in relation to Friars Walk. The Council has also entered into a number of financial guarantees where the Council has entered into agreements to act as a guarantor in particular safeguarding of former employee pension rights when their employment is transferred to third party organisations.

8. KNOWLEDGE AND SKILLS

IN-HOUSE EXPERTISE

The overall Capital Programme and Treasury Management Strategy are overviewed by the Head of Finance and Assistant Head of Finance, who are both professionally qualified accountants with extensive Local Government finance experience between them. There is a Capital Accounting team consisting of qualified and part-qualified accountants who follow Continuous Professional Development Plan (CPD) / attend courses on an ongoing basis to keep abreast of new developments and skills. There is a small Treasury Management team who manage the day-to-day cash-flow activities and banking arrangements of the authority, these again attend the necessary courses and training and have a vast amount of experience.

EXTERNAL EXPERTISE

All the Council's commercial projects have project teams from all the professional disciplines from across the Council and when required external professional advice is taken from the property advisors, Newport Norse, or other professional advice if required.

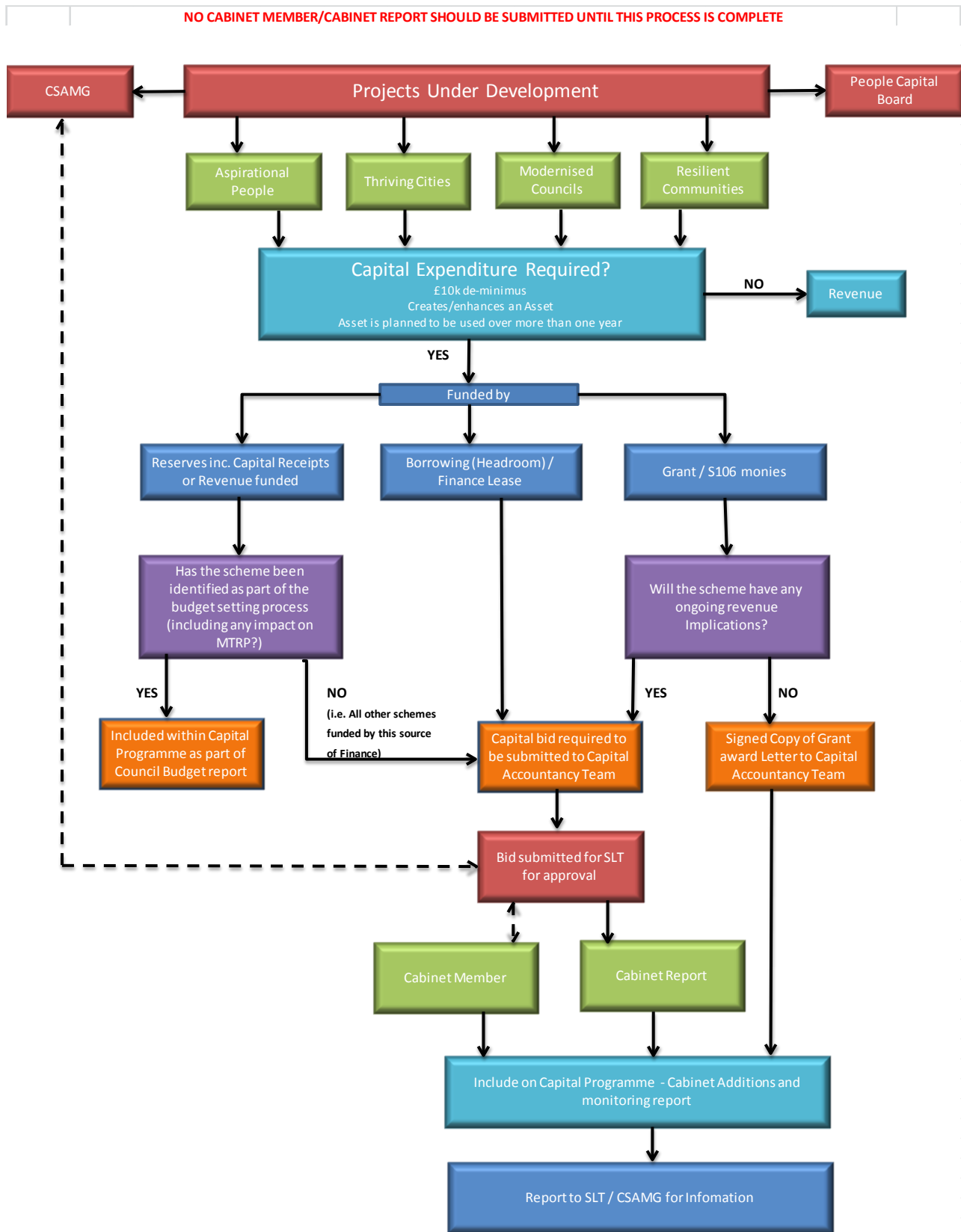
MEMBERS

Training is offered to members to ensure they have up to date skills to make capital and treasury decisions. A register is also kept on member attendance. The Council also involves members at a very early stage of a projects life cycle.

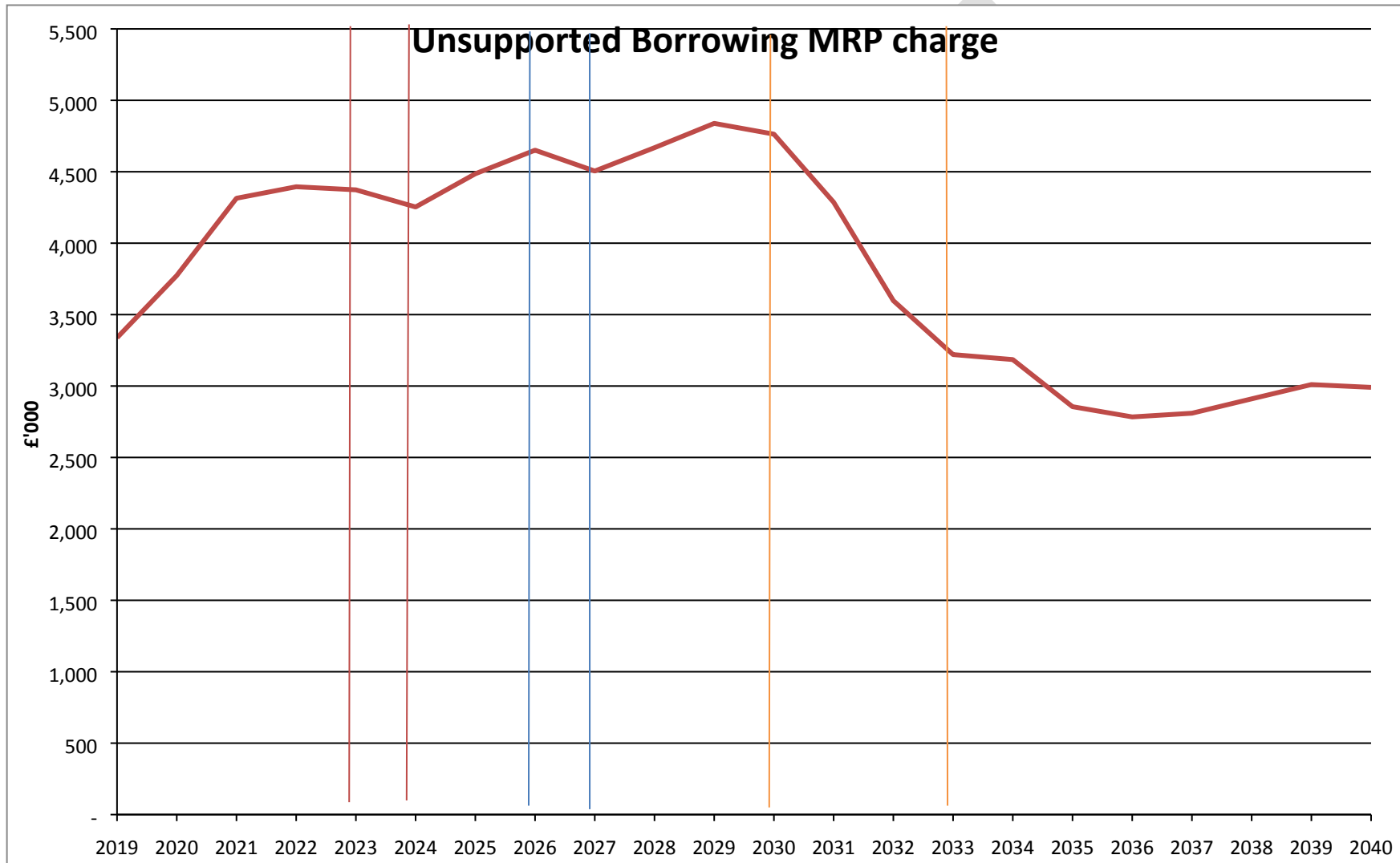
9. SUMMARY

- Capital expenditure plans for the Council need to be affordable, prudent and sustainable.
- The MTFP includes the current revenue costs for the capital programme, which includes level of headroom for additional capital projects to be added without impacting further on the revenue budget.
- As per the agreed framework the current programme needs to be maintained within the affordability headroom, therefore not putting additional pressure on the MRP budget.
- There are a number of demands on the capital programme, there is the need to link the capital strategy with a number of strategic plans across the organisation to ensure the pressures on the capital programme are known and the risks are assessed and prioritised within an affordable framework. This will include clear visibility and assessment of demand for schools, highways and other operational assets.
- Decisions on funding capital expenditure through borrowing locks the Council into committing revenue funding over a very long period (as long as 40 years +). With the MRP budget increasing over the long-term as shown in chart 1, the Council will need to make some difficult decisions going into the next programme to ensure the capital plans remain affordable and sustainable.

APPENDIX 2a – Capital Additions Process Map



Appendix 2b



Treasury Management Strategy Statement 2020/21

Introduction

Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management.

Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. In addition, the Welsh Government (WG) issued revised Guidance on Local Authority Investments in November 2019 that requires the Authority to approve an investment strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the WG Guidance.

Revised strategy: In accordance with the WG Guidance, the Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the Authority's capital programme or in the level of its investment balance, or a material loss in the fair value of a non-financial investment identified as part of the year end accounts preparation and audit process.

External Context

Economic background: The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2020/21.

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

GDP growth rose by 0.3% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.0% from 1.2%. Services and construction added positively to growth, by 0.6% and 0.4% respectively, while production was flat and agriculture recorded a fall of 0.2%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

The Bank of England maintained Bank Rate to 0.75% in November following a 7-2 vote by the Monetary Policy Committee. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.

Growth in Europe remains soft, driven by a weakening German economy which saw GDP fall -0.1% in Q2 and is expected to slip into a technical recession in Q3. Euro zone inflation was 0.8% year on year in September, well below the European Central Bank's target of 'below, but close to 2%' and leading to the central bank holding its main interest rate at 0% while cutting the deposit facility rate to -0.5%. In addition to maintaining interest rates at ultra-low levels, the ECB announced it would recommence its quantitative easing programme from November. In the US, the Federal Reserve began easing monetary policy again in 2019 as a pre-emptive strike against slowing global and US economic growth on the back on of the ongoing trade war with China. At its last meeting the Fed

cut rates to the range of 1.50-1.75% and financial markets expect further loosening of monetary policy in 2020. US GDP growth slowed to 1.9% annualised in Q3 from 2.0% in Q2.

Credit outlook: Credit conditions for larger UK banks have remained relatively benign over the past year. The UK's departure from the European Union was delayed three times in 2019 and while there remains some concern over a global economic slowdown, this has yet to manifest in any credit issues for banks. Meanwhile, the post financial crisis banking reform is now largely complete, with the new ringfenced banks embedded in the market. Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers.

Looking forward, the potential for a "no-deal" Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

Interest rate forecast: The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the upcoming general election, the need for greater clarity on Brexit and the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its November Monetary Policy Report and its Bank Rate decision (7-2 vote to hold rates) that the MPC now believe this is less likely even in the event of a deal.

Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix **A**.

For the purpose of setting the budget, it has been assumed that new treasury management investments will be made at an average rate of 2.5%, and that new long-term loans will be borrowed at an average rate of 3%.

Local Context

On 31st December 2019, the Authority held £150.8m of borrowing and £13.4m of treasury investments. This is set out in further detail at **Appendix 3b**. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	31.3.19 Actual £m	31.3.20 Estimate £m	31.3.21 Forecast £m	31.3.22 Forecast £m	31.3.23 Forecast £m
General Fund CFR	280.0	287.0	292.7	298.2	290.6
Less: Other debt liabilities *	(43.1)	(42.6)	(41.5)	(40.8)	(38.4)
Loans CFR	236.9	244.4	251.2	257.4	252.2
Less: External borrowing **	(192.8)	(149.4)	(145.6)	(138.7)	(134.7)
Less: Usable reserves	(102.9)	(85.1)	(77.4)	(73.7)	(69.3)
Less: Working capital	2.6	2.6	2.6	2.6	2.6
Preferred Investment position		10.0	10.0	10.0	10.0
Treasury Investments or (New borrowing)	56.2	(22.5)	(40.8)	(57.6)	(60.8)

* leases, PFI liabilities and transferred debt that form part of the Authority's total debt

** shows only loans to which the Authority is committed and excludes optional refinancing. The value at 31.3.2019 is netted off by the temporary investment value of £40m which was used to re-finance maturing borrowing in April 2019.

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. The Authority has an increasing CFR due to the capital programme, but minimal investments and will therefore be required to borrow up to £60.8m over the forecast period, this is broken down into £18.1m refinancing of maturing existing borrowing and £42.7m additional (£152.8m to £195.5m) external borrowing, while internal borrowing and investments are forecast to reduce by £33.6m and £6.2m respectively as shown in table 2 below.

Table 2: Year on year change in internal and external borrowing

	31.3.19 Actual £m	31.3.20 Estimate £m	31.3.21 Forecast £m	31.3.22 Forecast £m	31.3.23 Forecast £m
Loans CFR (as per table 1)	236.9	244.4	251.2	257.4	252.2
- Internal Borrowing	100.3	82.5	74.8	71.1	66.7
- Investments	(16.2)	(10.0)	(10.0)	(10.0)	(10.0)
- External Borrowing	152.8	171.9	186.4	196.3	195.5
Increase in External Borrowing		19.1	14.5	9.9	(0.8)
<i>Represented by:</i>					
Change in loan CFR (Cap Exp funded by debt less MRP)		7.5	6.8	6.2	(5.2)
Reduction in reserves		17.8	7.7	3.7	4.4
Reduction in investments		(6.2)	0	0	0
Increase in External Borrowing		19.1	14.5	9.9	(0.8)

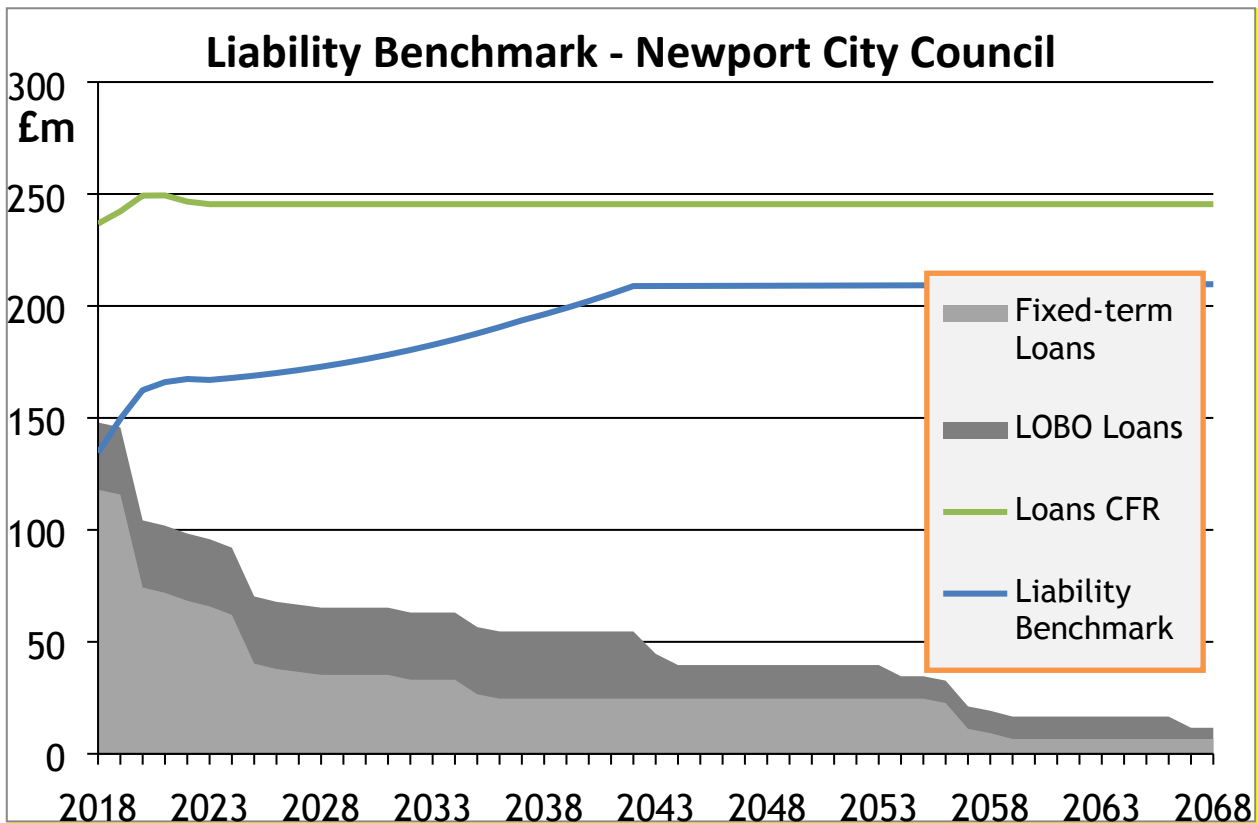
CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2020/21.

Liability benchmark: To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept to a minimum level of £10m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 3: Liability benchmark

	31.3.19 Actual £m	31.3.20 Estimate £m	31.3.21 Forecast £m	31.3.22 Forecast £m	31.3.23 Forecast £m
Loans CFR	237	244	251	257	252
Less: Usable reserves	(103)	(85)	(77)	(74)	(69)
Less: Working capital	3	3	3	3	3
Plus: Minimum investments	16	10	10	10	10
Liability Benchmark	153	172	186	196	196

Following on from the medium-term forecasts in table 3 above, the long-term liability benchmark assumes capital expenditure funded by borrowing at the same level as the minimum revenue provision therefore not increasing the CFR, and reserves in regards to the Private Finance Initiative (PFI) reserves being utilised over the life of the PFI contract. This is shown in the chart below:



The chart above shows actual borrowing maturing over time (grey area reducing), however our need to borrow (the green CFR line), over the long-term, remains at a consistent level due to the assumption that capital expenditure funded from borrowing will be at a level the same as the MRP charge. The Council need to borrow up to the liability benchmark (blue line) with the remaining amount being covered by internal borrowing as previously discussed. Therefore, the chart is showing the following important points/assumptions:

- The capital financing requirement is assumed to remain at a consistent level over the long-term.
- The ability to use further internal borrowing has diminished, with internal borrowing reducing over time as reserves are utilised.
- As existing borrowing matures (grey area reducing) there will be the need to refinance this debt over the long-term.
- The liability benchmark is increasing over time, meaning that the Council will be required to undertake new borrowing over time, therefore putting pressure on the revenue budget through increased interest payments.
- The only way to reduce this need to borrow is to reduce the level of capital expenditure funded by borrowing.

Borrowing Strategy

The Authority currently holds £150.8 million of loans, a decrease of £42 million on the previous year, as part of its strategy for funding previous years' capital programmes, there was a significant amount of temporary borrowing at year end to re-finance £40 million borrowing that was maturing in April 2020, this has now been carried out leading to this significant decrease in borrowing. The balance sheet forecast in table 1 shows that the Authority expects to borrow up to £40.8 million in 2020/21. The Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £290 million.

Objectives: The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal / short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2019/20 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The Authority has previously raised the majority of its long-term borrowing from PWLB but the government increased PWLB rates in October 2019 making it now a relatively expensive option. The Authority will now look to borrow any long-term loans from other sources including, banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over reliance on one source of funding in line with the CIPFA Code.

Alternatively, the Authority may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Authority may borrow short-term loans to cover unplanned cash flow shortages.

Sources of borrowing: The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except the Greater Gwent Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency and other special purpose companies created to enable local authority bond issues

Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- Sale and leaseback

Municipal Bonds Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

LOBOs: The Authority holds £30m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. £25m of these LOBOs have options during 2019/20, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so. Total borrowing via LOBO loans will be limited to £30m.

Short-term and variable rate loans: These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

Treasury Investment Strategy

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's treasury investment balance has ranged between £14.5 million and £69.0 million, levels of c. £10 to £20 million are expected in the forthcoming year.

Loans to organisations providing local public services i.e. regeneration and purchases of investment property are not normally considered to be treasury investments, and these are therefore covered separately in Appendix C.

Objectives: Both the CIPFA Code and the WG Guidance require the Authority to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Negative interest rates: If the UK enters into a recession in 2020/21, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy: Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to diversify into more secure and/or higher yielding asset classes during 2020/21. This is especially the case for the estimated £10 million that is available for longer-term investment. All of the Authority's surplus cash is currently invested in short-term unsecured bank deposits and local authorities. This diversification will represent a change in strategy over the coming year.

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

Approved counterparties: The Authority may invest its surplus funds with any of the counterparty types in table 4 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 4: Approved investment counterparties and limits

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£5m 5 years	£10m 20 years	£10m 50 years	£5m 20 years	£5m 20 years
AA+	£5m 5 years	£10m 10 years	£10m 25 years	£5m 10 years	£5m 10 years
AA	£5m 4 years	£10m 5 years	£10m 15 years	£5m 5 years	£5m 10 years

AA-	£5m 3 years	£10m 4 years	£10m 10 years	£5m 4 years	£5m 10 years
A+	£5m 2 years	£10m 3 years	£5m 5 years	£5m 3 years	£5m 5 years
A	£5m 13 months	£10m 2 years	£5m 5 years	£5m 2 years	£5m 5 years
A-	£5m 6 months	£5m 13 months	£5m 5 years	£5m 13 months	£5m 5 years
None	£1m 6 months	n/a	£10m 25 years	Not Applicable	£5m 5 years
Pooled funds and real estate investment trusts		£10m per fund or trust			

This table must be read in conjunction with the notes below

Credit rating: Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

Banks unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

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

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent.

Registered providers: Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

Pooled funds: Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

Real estate investment trusts: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. Investments in REIT shares cannot be withdrawn but can be sold on to the stock market to another investor.

Operational bank accounts: The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Authority’s treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “rating watch negative” or “credit watch negative”) so that it may fall below the approved rating criteria, then only investments that can be withdrawn will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other information on the security of investments: The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Authority’s treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

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

Investment limits: The Authority’s revenue reserves available to cover investment losses are forecast to be £75 million on 31st March 2020. In order that no more than 15% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £10 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers’ nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£10m each
UK Central Government	unlimited

Any group of organisations under the same ownership	£10m per group
Any group of pooled funds under the same management	£10m per manager
Negotiable instruments held in a broker's nominee account	£5m per broker
Foreign countries	£2m per country
Registered providers and registered social landlords	£5m in total
Unsecured investments with building societies	£5m in total
Money market funds	£10m in total
Real estate investment trusts	£10m in total

Liquidity management: The Authority uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium-term financial plan and cash flow forecast.

Treasury Management Indicators

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

Interest rate exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper-limit on the one-year revenue impact of a 1% rise or fall of interest rates will be:

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of 1% <u>rise</u> in interest rates	£200,000
Upper limit on one-year revenue impact of 1% <u>fall</u> in interest rates	£100,000

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

Refinancing rate risk indicator	Upper	Lower
Under 12 months	60%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	40%	0%
10 years and within 20 years	30%	0%
20 years and within 30 years	20%	0%
30 years and within 40 years	20%	0%
40 years and within 50 years	20%	0%
50 years and above	20%	0%

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

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

Price risk indicator	2020/21	2021/22	2022/23
Limit on principal invested beyond year end	£10m	£10m	£10m

Related Matters

The CIPFA Code requires the Authority to include the following in its treasury management strategy.

Financial Derivatives: In the absence of any explicit legal power to do so, the Authority will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

Markets in Financial Instruments Directive: The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Head of Finance believes this to be the most appropriate status.

Government Guidance: Further matters required by the WG Guidance are included in Appendix 3c

Financial Implications

The budget for investment income in 2020/21 is £0.3 million, based on an average investment portfolio of £10 million at an interest rate of 3%. The budget for debt interest paid in 2020/21 is £7.2 million, based on an average debt portfolio of £2.7 million at an average interest rate of 4.0%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

Other Options Considered

The WG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Head of Finance believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Appendix 3a - Arlingclose Economic & Interest Rate Forecast November 2019

Underlying assumptions:

- The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased.
- Some positivity on the trade negotiations between China and the US has prompted worst case economic scenarios to be pared back. However, information is limited, and upbeat expectations have been wrong before.
- Brexit has been delayed until 31 January 2020. While the General Election has maintained economic and political uncertainty, the opinion polls suggest the Conservative position in parliament may be strengthened, which reduces the chance of Brexit being further frustrated. A key concern is the limited transitional period following a January 2020 exit date, which will maintain and create additional uncertainty over the next few years.
- UK economic growth has stalled despite Q3 2019 GDP of 0.3%. Monthly figures indicate growth waned as the quarter progressed and survey data suggest falling household and business confidence. Both main political parties have promised substantial fiscal easing, which should help support growth.
- While the potential for divergent paths for UK monetary policy remain in the event of the General Election result, the weaker external environment severely limits potential upside movement in Bank Rate, while the slowing UK economy will place pressure on the MPC to loosen monetary policy. Indeed, two MPC members voted for an immediate cut in November 2019.
- Inflation is running below target at 1.7%. While the tight labour market risks medium-term domestically-driven inflationary pressure, slower global growth should reduce the prospect of externally driven pressure, although political turmoil could push up oil prices.
- Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- Although we have maintained our Bank Rate forecast at 0.75% for the foreseeable future, there are substantial risks to this forecast, dependant on General Election outcomes and the evolution of the global economy.
- Arlingclose judges that the risks are weighted to the downside.
- Gilt yields have risen but remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.
- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.21
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.73
3-month money market rate														
Upside risk	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.25
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.73
1yr money market rate														
Upside risk	0.10	0.20	0.20	0.20	0.20	0.20	0.20	0.25	0.30	0.30	0.30	0.30	0.30	0.23
Arlingclose Central Case	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85
Downside risk	-0.30	-0.50	-0.55	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.60
5yr gilt yield														
Upside risk	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.45	0.45	0.45	0.37
Arlingclose Central Case	0.50	0.50	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.57
Downside risk	-0.35	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.56
10yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Case	0.75	0.75	0.80	0.80	0.85	0.85	0.90	0.90	0.95	0.95	1.00	1.00	1.00	0.88
Downside risk	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.45
20yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Case	1.20	1.20	1.25	1.25	1.25	1.30	1.30	1.30	1.35	1.35	1.35	1.40	1.40	1.30
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.45
50yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Case	1.20	1.20	1.25	1.25	1.25	1.30	1.30	1.30	1.35	1.35	1.35	1.40	1.40	1.30
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.45

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

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

Appendix 3b - Existing Investment & Debt Portfolio Position

	31/12/2019 Actual Portfolio £m	31/12/2019 Average Rate %
External borrowing:		
Public Works Loan Board	107.1	3.7
Local authorities	0	-
LOBO loans from banks	30.0	4.4
Other loans	13.6	3.8
Total external borrowing	150.8	3.7
Other long-term liabilities:		
Private Finance Initiative	43.0	
Finance Leases	0.1	
Total other long-term liabilities	43.1	
Total gross external debt	193.9	
Treasury investments:		
Banks & building societies (unsecured)	3.4	0.5
Government (incl. local authorities)	10	0.7
Total treasury investments	13.4	0.82
Net debt	180.4	

Appendix 3c - Additional requirements of Welsh Government Guidance

The Welsh Government (WG) published revised Investment Guidance in November 2019 which places additional reporting requirements upon local authorities that are not integral to this Authority's treasury management processes. The guidance also covers investments that are not part of treasury management, for example investment property and loans to local organisations.

Contribution: The Authority's investments contribute to its service delivery objectives and/or to promote wellbeing as follows:

- treasury management investments support effective treasury management activities,
- loans to local organisations provide financial support to those organisations to enable them to deliver local public services that would otherwise be provided directly by the Authority, and
- investment property provides a net financial surplus that is reinvested into local public services.

Climate change: The Authority's investment decisions consider long-term climate risks to support a low carbon economy to the extent that the Council have invested in our capital programme a number of energy efficiency related schemes, including LED projects and Solar PV.

Specified investments: The WG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement unless the counterparty is a local authority,
- not defined as capital expenditure by legislation, and
- invested with one of:
 - the UK Government,
 - a UK local authority, parish council or community council, or
 - a body or investment scheme of "high credit quality".

The Authority defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

Loans: The WG Guidance defines a loan as a written or oral agreement where the authority temporarily transfers cash to a third party, joint venture, subsidiary or associate who agrees a return according to the terms and conditions of receiving the loan, except where the third party is another local authority.

The Authority uses an allowed 'expected credit loss' model for loans and receivables as set out in *International Financial Reporting Standard 9 Financial Instruments* as adopted by proper practices to measure the credit risk of its loan portfolio. Appropriate consideration is given to state aid rules and competition law. The Authority has appropriate credit control arrangements to recover overdue repayments in place.

Non-specified investments: Any financial investment not meeting the definition of a specified investment or a loan is classed as non-specified. Given the wide definition of a loan, this category only applies to units in pooled funds and shares in companies. Limits on non-specified investments are shown in table C2; the Authority confirms that its current non-specified investments remain within these limits.

Table C2: Non-specified investment limits

	Cash limit
Units in pooled funds without credit ratings or rated below [A-]	£10m
Shares in real estate investment trusts	£10m
Total non-specified investments	£10m

Non-financial investments: This category covers non-financial assets held primarily or partially to generate a profit, primarily investment property. Security is determined by comparing each asset's purchase price to its fair value using the model in International Accounting Standard 40: Investment Property as adapted by proper practices. On an assessment as at 31st March 2019, the Authority's investment property portfolio [provides / does not provide] security for capital investment since its fair value of £[X]m is [above / below] its purchase price of

£[X]m. [The Authority is therefore taking the following mitigating actions to protect the capital invested: list the actions] [WG 34 and 40-41]

The Authority consider that the scale of its commercial investments including property are proportionate to the resources of the authority since such investments represent just [X]% of its £[X]m [some measure of resources, e.g. annual income or reserves]. [WG 35]

Liquidity: Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Authority [explain the procedures in place for ensuring this, by class of asset or at a portfolio level if appropriate]. [WG 44-45]

Yield (net profit): Only include this section where relevant. The Authority utilises its profit generating investment activity to achieve a balanced revenue budget. Table C3 below details the extent to which funding expenditure to meet the service delivery objectives and or promote wellbeing in the Authority is dependent on achieving the expected yield over the life cycle of the Medium Term Financial Plan. Should it fail to achieve the expected net profit, the Authority's contingency plans for continuing to provide these services are [explain contingency arrangements]. [WG 46-47]

Table C3: Proportionality of Investments

	2018/19 Actual	2019/20 Forecast	2020/21 Budget	2021/22 Budget	2022/23 Budget
Gross service expenditure					
Investment income					
Proportion	%	%	%	%	%

The proportion is the investment income divided by the gross service expenditure

Investment advisers: The Authority has appointed Arlingclose Limited as treasury management advisers and Newport Norse as property investment advisers. The quality of these services is controlled by regular review of the services provided by both advisers and regular strategy meeting with them.

Appendix 3d - Minimum Revenue Provision Policy

Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Authority to have regard to the Welsh Government's *Guidance on Minimum Revenue Provision* (the WG Guidance) most recently issued in 2010.

The broad aim of the WG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The WG Guidance requires the Authority to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance.

For supported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in equal instalments, this is currently deemed to be an average of 40 years.

For unsupported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in on an annuity basis with an annual interest rate equal to the average relevant PWLB rate for the year of expenditure, starting in the year after the asset becomes operational.

For capital expenditure loans to third parties that are repaid over a short time period or more frequent instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead.

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

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

	31.03.2020 Estimated CFR £m	2020/2021 Estimated MRP £m
Supported capital expenditure	163	4
Unsupported capital expenditure	81	3
Finance leases and Private Finance Initiative	43	1
Total General Fund	287	9