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Chairman and Members of the Performance, Audit and Governance Scrutiny Committee	Your contact:	Lorraine Blackburn
	Ext:	2172
	Date:	14 January 2019

cc. All other recipients of the Performance, Audit and Governance Scrutiny Committee agenda

Dear Councillor

PERFORMANCE, AUDIT AND GOVERNANCE SCRUTINY COMMITTEE - 22 JANUARY 2019

Please find attached the following reports which were marked “to follow” on the agenda for the above meeting:

5. Annual Audit Letter and External Grants Certification Summary (Pages 3 - 38)
6. Treasury Management - Mid year Review 2017-18 (Pages 39 - 160)
7. Treasury Management and capital strategies for 2019/20 (Pages 161 - 250)
8. Capital Strategy - Going Forward (Pages 251 - 290)

Please bring these papers with you to the meeting next Tuesday

Yours faithfully

Lorraine Blackburn

Democratic Services Officer
Lorraine Blackburn@eastherts.gov.uk

MEETING	**:**	PERFORMANCE, AUDIT AND GOVERNANCE SCRUTINY COMMITTEE
VENUE	**:**	COUNCIL CHAMBER, WALLFIELDS, HERTFORD
DATE	**:**	TUESDAY 22 JANUARY 2019
TIME	**:**	7.00 PM

East Hertfordshire District Council

Annual Audit Letter for the year ended 31 March 2018

August 2018

Agenda Item 5

EY

Building a better working world

Contents

Public Sector Audit Appointments Ltd (PSAA) have issued a 'Statement of responsibilities of auditors and audited bodies'. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk)

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The 'Terms of Appointment (updated 23 February 2017)' issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

01 Executive Summary

Executive Summary

We are required to issue an Annual Audit Letter to East Hertfordshire District Council following completion of our audit procedures for the year ended 31 March 2018.
Below are the results and conclusions on the significant areas of the audit process. .

Area of Work	Conclusion
Opinion on the Council's: ► Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council as at 31 March 2018 and of its expenditure and income for the year then ended
► Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts.
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources

Area of Work	Conclusion
Reports by exception:	
► Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Council.
► Public interest report	We had no matters to report in the public interest.
► Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
► Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	The Council is below the specified audit threshold of £500 million. Therefore, we did not perform any audit procedures on the consolidation pack.

Executive Summary (cont'd)

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 17 July 2018
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 31 July 2018

In December 2018 we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken.

We would like to take this opportunity to thank the Council's staff for their assistance during the course of our work.

Debbie Hanson

Executive Director

For and on behalf of Ernst & Young LLP

02 Purpose and Responsibilities

Purpose and Responsibilities

The Purpose of this Letter

The purpose of this Annual Audit Letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2017/18 Audit Results Report to the July 2018 Performance, Audit and Governance Scrutiny Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

Responsibilities of the Appointed Auditor

Our 2017/18 audit work has been undertaken in accordance with the Audit Plan that we issued on March 2018 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- Expressing an opinion:
  - On the 2017/18 financial statements; and
  - On the consistency of other information published with the financial statements.
- Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- Reporting by exception:
  - If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - Any significant matters that are in the public interest;
  - Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on you Whole of Government Accounts return. The Council is below the specified audit threshold of £500 million. Therefore, we did not perform any audit procedures on the return.

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement (AGS). In the AGS, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

03 Financial Statement Audit

Financial Statement Audit

Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Council's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on July 2018.

Our detailed findings were reported to the July 2018 Performance, Audit and Governance Scrutiny Committee.

The key issues identified as part of our audit were as follows:

Significant Risk	Conclusion
Misstatements due to fraud or error The financial statements as a whole are not free of material misstatements whether caused by fraud or error. As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement. For the Council, we identified the potential for the incorrect classification of revenue spend as capital as a particular area where there is a risk of misstatement.	We obtained a full list of journals posted to the general ledger during the year, and analysed these journals using criteria we set to identify any unusual journal types or amounts. We then tested journals that met our criteria and tested these to supporting documentation. We considered the accounting estimates relating to pensions and property valuations as the most susceptible to bias. We challenged the significant assumptions in the actuarial pension valuation and found no indication of management bias in these estimates. Our work on the property valuations found no material errors in the balances presented within the financial statements. We performed sample testing on additions to the property, plant and equipment balance and found that these items met the relevant accounting requirements to be capitalised. Our testing did not identify any expenditure which had been inappropriately capitalised. We have not identified any material weaknesses in controls or evidence of material management override. We have not identified any instances of inappropriate judgements being applied. We did not identify any other material transactions during our audit which appeared unusual or outside the Council's normal course of business. Overall our audit work did not identify any material issues or unusual transactions to indicate any misreporting of the Council's financial position, that revenue or expenditure has been incorrectly recorded or that management has overridden control.

Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

Significant Risk	Conclusion
Investment property valuation (Old River Lane) The Old River Lane site was purchased by the Council during 2015 and classified as an investment asset in the Council's 2015/16 and 2016/17 accounts. The Council is continuing to develop its proposal for the use of this site which will eventually result in changes in its classification. Due to the material nature of the asset, small changes in assumptions when valuing it could have a material impact on the Council's financial statements.	We assessed the classification of the Old River Lane assets, the valuation basis that was assigned as a result and any material increases or impairments that arise during 2017/18. We assessed the work of the property valuers in respect of the Council's Investment Property portfolio and identified and challenged the key assumptions and valuation methodology for the Old River Lane assets. We reviewed and tested the accounting entries and disclosures made within the Council's financial statements. As a result of our work we: • confirmed that Old River Lane was correctly classified as Investment Property. • confirmed that the property was measured accurately at fair value through the rental income it generates. • assessed the work of the internal valuers in respect of this specific property and concluded assumptions made to be reasonable • confirmed that the accounting entries and disclosures made in respect of this property within the Council's financial statements were accurate and complete. We therefore concluded that overall financial statement disclosure were fairly stated in respect of Old River Lane

Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

Other Key Findings	Conclusion
Property, plant and equipment valuations Property, plant and equipment (PPE) represents a significant balance in the Council's accounts and is subject to valuation changes, impairment reviews and depreciation charges. Material judgemental inputs and estimation techniques are required to calculate the year-end PPE balances held in the balance sheet. As the Council's asset base is significant, and the outputs from the valuer are subject to estimation, there is a higher inherent risk PPE may be under/overstated or the associated accounting entries incorrectly posted. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of experts and assumptions underlying fair value estimates.	We are satisfied that the Council's valuers have the necessary qualifications and experience. We have undertaken appropriate audit procedures to verify and critically challenge the basis of valuation adopted by the valuer in relation to the Council's property, Our testing has not identified any material misstatements from inappropriate judgements being applied to the property valuation estimates. The expert valuers possess the relevant qualifications and experience, and undertook a review of all of the Authority's assets. We considered the underlying assumptions made by the expert valuer and concluded that they were reasonable.
Pension liability valuation The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding the Local Government Pension Scheme (LGPS) in which it is an admitted body. The Council's current pension fund deficit is a highly material and sensitive item and the Code requires that this liability be disclosed on the Council's balance sheet. The information disclosed is based on the IAS 19 report issued to the Council by the actuary. As with other councils, accounting for this scheme involves significant estimation and judgement and due to the nature, volume and size of the transactions we consider this to be a higher inherent risk.	We assessed and were satisfied with the competency and objectivity of the Council's actuary. EY Pensions team and PwC (Consulting Actuary to the NAO) reviewed the work of the actuary. We challenged the significant movement in the actuarial valuation and found no indication of management bias in this estimate. We have received reports from the Hertfordshire Pension Fund Auditor and the EY actuarial team. The report from the Pension Fund Auditor identified material movements in the pension assets and related disclosures, as a result of significant movements in the asset values between the date of the estimates used by the actuary to produce the IAS19 report and the year end. As a result, the Council obtained a revised IAS 19 report and updated the accounts to reflect the new figures. This resulted in an decrease in the pension liability of £1.734 million and a corresponding decrease in the pension reserve. The accounting entries and disclosures are in line with our expectations and the Code.

Financial Statement Audit (cont'd)

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Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	Thresholds applied
Planning materiality	We determined planning materiality to be £1.1 million (2016/17: £1.53 million), which is 2% of gross expenditure reported in the accounts of £76.4 million . We consider gross expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.
Reporting threshold	We agreed with the Performance, Audit and Governance Scrutiny Committee that we would report to the Committee all audit differences in excess of £0.076 million (2016/17: £0.076 million).

We also identified the following areas where misstatement at a level lower than our overall materiality level might influence the reader. For these areas we developed an audit strategy specific to these areas. The areas identified and audit strategy applied include:

- Remuneration disclosures including any severance payments, exit packages and termination benefits:
- Related party transactions.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations.

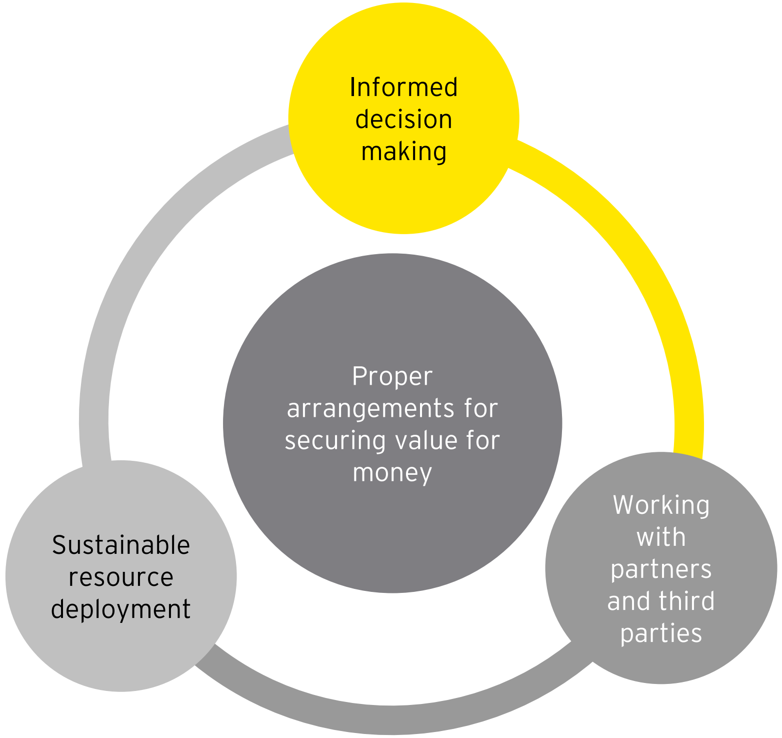
04 Value for Money

Value for Money

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.



We identified one significant risk around these arrangements, in relation to the development of Old River Lane, establishment of a housing company and the review of the leisure strategy.

The tables below present our findings in response to the risk included in our Audit Planning Report and any other issues we want to bring to your attention.
We have completed the work outlined in our audit plan and expect having no matters to report about your arrangements to secure economy, efficiency and effectiveness in your use of resources.

We have performed the procedures outlined in our audit plan. We did not identify any significant weaknesses in the Council's arrangements.

Value for Money (cont'd)

We therefore issued an unqualified value for money conclusion on 31 July 2018

Significant Risk	Conclusion
Development of Old River Lane, housing company and Leisure Strategy The Council purchased Old River Lane for investment purposes during 2015/16. Plans for the site are continuing to be developed, and decisions that the Council is making now, will impact on the revenue and capital costs relating to the project, in current as well as future years. In addition to the Old River Lane development, the Council is also looking to establish a housing company and develop a longer term leisure strategy. These developments are significant projects for the Council which will require financial investment and present challenges in terms of governance, financial and risk management as well as partnership working.	We have assessed the arrangements in place supporting these developments, focusing on: • Assessing the governance and financial and risk management arrangements in place to support key decision making • Understanding the financial implications and the key decisions being made • Understanding how the Council is working with other bodies and partners in relation to these projects. We have not identified any issues in the review of the arrangements in place for these developments. In relation to Old River Lane, which is the main project we have focused on we note that: ▪ The Old River Land Development Board was established in early 2017 and is dedicated to the development of the site ▪ The renamed Bishop's Stortford Town Centre Steering Board retained oversight of the Town Centre development as a whole. ▪ The Old River Land Development Board commissioned and received appropriate professional advice and support in relation to the development of proposals for the site, as well as cost estimates and a viability analysis. We are therefore satisfied that the information provide to Members and Officers in respect of the project is appropriate and is based on third party assessments and advice from appropriately knowledgeable professionals with relevant experience. We have seen evidence to indicate that this advice has been utilised in the discussions and decisions around the project.

05 Other Reporting Issues

Other Reporting Issues

Whole of Government Accounts

The Council is below the specified audit threshold of £500 million. Therefore, we did not perform any audit procedures on the consolidation pack.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's Annual Governance Statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We completed this work and did not identify any areas of concern.

Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

Other Reporting Issues (cont'd)

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Objections Received

We did not receive any objections to the 2017/18 financial statements from members of the public.

Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

Independence

We communicated our assessment of independence in our Audit Results Report to the Performance, Audit and Governance Scrutiny Committee on 24 July 2018. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

Control Themes and Observations

It is the responsibility of the Authority to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your auditor is to consider whether the Authority has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

As part of our audit of the financial statements, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. As we have adopted a fully substantive approach, we have therefore not tested the operation of controls.

Although our audit was not designed to express an opinion on the effectiveness of internal control we are required to communicate to you significant deficiencies in internal control.
We have not identified any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in your financial statements of which you are not aware.

07 Focused on your future

Focused on your future

The Code of Practice on Local Authority Accounting in the United Kingdom introduces the application of new accounting standards in future years. The impact on the Council is summarised in the table below.

Standard	Issue	Impact
IFRS 9 Financial Instruments	Applicable for local authority accounts from the 2018/19 financial year and will change: ▸ How financial assets are classified and measured; ▸ How the impairment of financial assets are calculated; and ▸ The disclosure requirements for financial assets. There are transitional arrangements within the standard and the 2018/19 Accounting Code of Practice for Local Authorities has now been issued, providing guidance on the application of IFRS 9. In advance of the Guidance Notes being issued, CIPFA have issued some provisional information providing detail on the impact on local authority accounting of IFRS 9, however the key outstanding issue is whether any accounting statutory overrides will be introduced to mitigate any impact.	The Council's view is that the impact of this standard on the Authority's financial statements will be immaterial. The Council will need to keep this standard under continued focus during 2018/19 because statutory overrides may be introduced by Central Government.
IFRS 15 Revenue from Contracts with Customers	Applicable for local authority accounts from the 2018/19 financial year. This new standard deals with accounting for all contracts with customers except: ▸ Leases; ▸ Financial instruments; ▸ Insurance contracts; and ▸ For local authorities; Council Tax and NDR income. The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations. Now that the 2018/19 Accounting Code of Practice for Local Authorities has been issued it is becoming clear what the impact on local authority accounting will be. As the vast majority of revenue streams of Local Authorities fall outside the scope of IFRS 15, the impact of this standard is likely to be limited.	Given the nature of the Council's income streams, it is unlikely that the future implementation of IFRS 15 will have a material impact on the financial statements of the Council. The vast majority of the Council's income streams are taxation or grant based, and are therefore outside the scope of IFRS15. The following income streams which are within the scope of IFRS 15 may be considered material by the Council in making its assessment of the impact on IFRS 15 in its 2018/19 accounts: • fees and charges for services under statutory requirements, .g. application fees for taxi licenses or planning fees; • sale of goods provided by the authority e.g. retail sales at leisure centres, concessionary sale at local authority theatres; and • charges for services provided by a local authority e.g. maintenance for council dwellings or transport fares

Focused on your future (cont'd)

Standard	Issue	Impact
IFRS 16 Leases	It is currently proposed that IFRS 16 will be applicable for local authority accounts from the 2019/20 financial year. Whilst the definition of a lease remains similar to the current leasing standard; IAS 17, for local authorities who lease a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet. There are transitional arrangements within the standard and although the 2019/20 Accounting Code of Practice for Local Authorities has yet to be issued, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue.	Until the 2019/20 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area. However, what is clear is that the Council will need to undertake a detailed exercise to identify all of its leases and capture the relevant information for them. The Council must therefore ensure that all lease arrangements are fully documented.

08 Audit Fees

Audit Fees

Our fee for 2017/18 is in line with the scale fee set by the PSAA and reported in our July 2018 Audit Plan and Annual Results Report.

	Final Fee 2017/18	Planned Fee 2017/18	Scale Fee 2017/18	Final Fee 2016/17
	£	£	£	£
Total Audit Fee – Code work	54,826*	52,331	52,331	57,196 **
Total Non-audit work - Grants	TBC	£8.316	£8,316	4,759 ***

*We are proposing a scale fee variation in relation to the additional work that had to be done to support our value for money conclusion as a result of a significant risk linked to the various projects the Council has ongoing to bridge the medium term budget gap. These include the development of Old River lane, setting up a wholly owed company and review of the leisure strategy. This variation will need to be agreed with management and is subject to approval by PSAA

** We proposed a scale fee variation in relation to our 2016/17 audit in relation to a number of issues which have previously been reported to the Council. PSAA has reviewed this variation and approved an additional fee od £4,865. This has therefore been added to the scale fee of £52,331 in the table above to give the total fee.

*** the 2016/17 grant fee reflects a rebate of £1,196 agreed to reflect the additional work performed by the Council.

TBC - as we have not yet completed our audit of the 2017/18 Housing Subsidy claim we are not able to confirm the fee for this work

We confirm we have not undertaken any non-audit work outside of the PSAA's requirements.

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ED None

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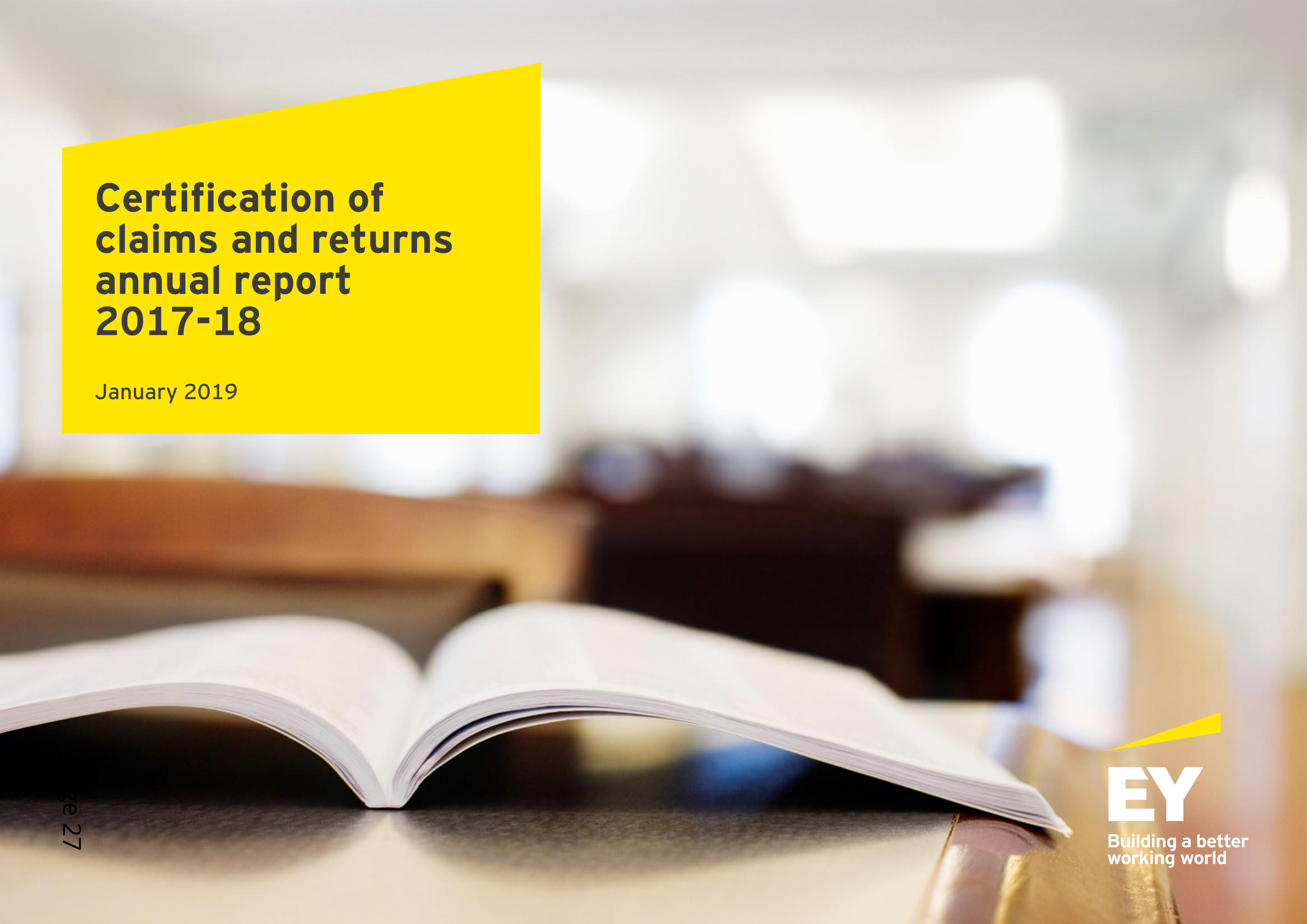
Certification of claims and returns annual report 2017-18

January 2019



Building a better working world

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This report is made solely to the Audit and Governance Scrutiny Committee and management of East Hertfordshire District Council in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Audit and Governance Scrutiny Committee, and management of East Hertfordshire District Council those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Audit and Governance Scrutiny Committee, and management of East Hertfordshire District Council for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.

01 Housing benefits subsidy claim

Housing benefits subsidy claim

Scope of work	Results
Value of claim presented for certification	£34,474,133
Amended/Not amended	Not amended
Qualification letter	Yes
Fee – 2017-18	£9,288 (this is subject to agreement by PSAA)
Fee – 2016-17	£4,759

Recommendations from 2016-17	Findings in 2017-18
None	N/a

Local Government administers the Government's housing benefits scheme for tenants and can claim subsidies from the Department for Work and Pensions (DWP) towards the cost of benefits paid.

The certification guidance requires reporting accountants to complete more extensive '40+' or extended testing if initial testing identifies errors in the calculation of benefit or compilation of the claim. 40+ testing may also be carried out as a result of errors that have been identified in the certification of previous years claims. We found errors and carried out extended testing on earned income cases.

We have reported underpayments, uncertainties and the extrapolated value of other errors in a qualification letter. The DWP then decides whether to ask the Council to carry our further work to quantify the error or to claw back the benefit subsidy paid.

The main issue we reported was that there was one case in the initial sample and one in the extended sample where the value of child care costs used in assessing the claim was incorrect resulting in overpayments of benefit of £2,136 and £628 respectively. The other errors identified on earned income cases were all of a much smaller value.

03 2017-18 certification fees

2017-18 certification fees

The PSAA determine a scale fee each year for the certification of the housing benefits subsidy claim. For 2017-18, these scale fees were published by the Public Sector Audit Appointments Ltd (PSAA's) and are available on their website (www.psaa.co.uk).

Claim or return	2017-18	2017-18	2016-17
	Actual fee £	**Indicative fee £**	**Actual fee £**
Housing benefits subsidy claim	£9,288	£8,316	£4,759

The indicative fee for 2017-18 was based on the outturn fee in 2015-16. In 2015-16 there was no extended testing and the initial testing was undertaken by the EY team. In 2017-18 an extended sample was required on earned income and the initial sample and the extended sample testing were both undertaken by the client shared service team. We have taken into account the input from the shared service team in undertaking the testing but have had to increase the fee overall due to the extended testing which involves the EY team reviewing more cases than in 2016-17, calculating extrapolated errors and drafting a qualification letter. The fee set out above for 2017-18 is subject to agreement by the Chief Finance Officer and PSAA.

The 2016-17 final fee of £4,759 reflected a 20% reduction on the scale fee of £5,955 as the Council's Benefit Team undertook the initial testing which we then reviewed.

04 Looking forward

Looking forward

2018/19 and beyond

From 2018/19, the Council is responsible for appointing their own reporting accountant to undertake the work on their claims in accordance with the instructions determined by the relevant grant paying body.

As your appointed auditor for the financial statements audit, we would be only too pleased to undertake this work for you and realise the synergies and efficiencies that can be achieved from undertaking both the financial statements audit and the grant work.

05 Summary of recommendations

Summary of recommendations

This section highlights the recommendations from our work and the actions agreed.

Recommendation	Priority	Agreed action and comment	Deadline	Responsible officer
Housing benefits subsidy claim	High	There were two large errors identified in case testing that were due to the incorrect treatment of child care costs. Training should be given to staff on how to calculate weekly child care costs.	31 March 2019	Head of Revenues & Benefits Services

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ED None

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EAST HERTS COUNCIL

PERFORMANCE, AUDIT AND GOVERNANCE SCRUTINY COMMITTEE – 22 JANUARY 2019

REPORT BY EXECUTIVE MEMBER FOR FINANCE AND SUPPORT SERVICES

TREASURY MANAGEMENT MID-YEAR REVIEW 2018-19

WARD(S) AFFECTED: NONE

Purpose/Summary of Report

The report reviews the Council's treasury management activities for the first 6 months of 2018/19 financial year, including the prudential indicators.

RECOMMENDATION(S) FOR FOR PERFORMANCE, AUDIT AND GOVERNANCE COMMITTEE: to recommend to the Executive that:	
(A)	**The Treasury management activity and prudential indicators for the first 6 months of the 2017/18 financial year be approved.**

1.0 Background

1.1 Treasury management is defined as: 'The management of the Council's investments and cash flows, its banking arrangements, money market and capital transactions; the effective control of the risks associated with these activities; and the pursuit of optimum returns consistent with the Council's risk management policy for treasury management.'

1.2 This activity is supported by the council's appointed independent advisors – Link Asset Services.

1.3 The Council is required by regulations under the Local Government Act 2003 to produce a treasury management mid-year review of activities and prudential and treasury indicators for 2018/19.

1.4 This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

1.5 The Council is required by the CIPFA Prudential Code to approve a treasury management mid-year review describing the activity compared to the strategy.

2.0 Report

2.1 Please refer to the Treasury Management Mid-Year Review, Essential Reference Paper 'B': Treasury Management Mid-Year Review 2018-19.

3.0 Implications/Consultations

3.1 Information on any corporate issues and consultation associated with this report can be found within **Essential Reference Paper 'A'**.

Background Papers
CIPFA Code of Practice on Treasury Management (2017)
CIPFA Prudential Code for Capital Finance in Local Authorities (2017)

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IMPLICATIONS/CONSULTATIONS

Contribution to the Council's Corporate Priorities/ Objectives*:*	Priority 1 – Improve the health and wellbeing of our communities Priority 2 – Enhance the quality of people's lives Priority 3 – Enable a flourishing local economy
Consultation:	Not Applicable
Legal:	The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (Treasury Management Strategy Statement, annual and midyear reports). This report therefore ensures this Council is implementing best practice in accordance with the Code. The report fulfils the following legislative requirements: • Reporting of prudential Indicators in line with the requirements of the CIPFA Code of Practice. • Reporting to those charged with governance a mid-year treasury management report.
Financial:	Within the body of the report.
Human Resource:	Not Applicable
Risk Management:	Within the body of the report.
Health and wellbeing – issues and	Not Applicable

impacts:	
Equality Impact Assessment required:	No

East Herts District Council Treasury Management Strategy Statement and Annual Investment Strategy

Mid-Year Review Report 2018/19

1. Background

1.1 Capital Strategy

In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities will be required to prepare a Capital Strategy which is intended to provide the following:

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

A report setting out our Capital Strategy will be taken to the full council on 5th March 2019.

1.2 Treasury management

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the Council’s capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Accordingly, treasury management is defined as:

> “The management of the local authority’s borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

2. Introduction

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report, (stewardship report), covering activities during the previous year.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Performance, Audit and Governance Scrutiny Committee.

This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2018/19 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure, as set out in the Capital Strategy, and prudential indicators;
- A review of the Council's investment portfolio for 2018/19;
- A review of the Council's borrowing strategy for 2018/19;
- A review of any debt rescheduling undertaken during 2018/19;
- A review of compliance with Treasury and Prudential Limits for 2018/19.

3. Economics and interest rates

3.1 Economics update

UK. The first half of 2018/19 has seen UK **economic growth** post a modest performance, but sufficiently robust for the Monetary Policy Committee, (MPC), to unanimously (9-0) vote to increase **Bank Rate** on 2nd August from 0.5% to 0.75%. Although growth looks as if it will only be modest at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

Some MPC members have expressed concerns about a build-up of **inflationary pressures**, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.4% in June to 2.7% in August due to increases in volatile components, but is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate. The MPC has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019.

As for the **labour market,** unemployment has continued at a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high in July, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 2.9%, (3 month average regular pay, excluding bonuses) and to a one month figure in July of 3.1%. This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 0.4%, near to the joint high of 0.5% since 2009 (The previous high point was in July 2015). Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC were right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

However, the MPC will need to tread cautiously before increasing Bank Rate again, especially given all the uncertainties around Brexit.
In the **political arena**, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

USA. President Trump's massive easing of fiscal policy is fuelling a (temporary) boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2, but also an upturn in inflationary pressures. With inflation moving towards 3%, the Fed increased rates another 0.25% in September to between 2.00% and 2.25%, this being four increases in 2018, and indicated they expected to increase rates four more times by the end of 2019. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on a number of countries' exports to the US, (China in particular), could see a switch to US production of some of those goods, but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Fed in the second half of 2019.

EUROZONE. Growth was unchanged at 0.4% in quarter 2, but has undershot early forecasts for a stronger economic performance in 2018. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of 2% for 2018, the horizon is less clear than it seemed just a short while ago.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

JAPAN has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

3.2 Interest rate forecasts

The Council's treasury advisor, Link Asset Services, has provided the following forecast:

Link Asset Services Interest Rate View											
	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

The flow of generally positive economic statistics after the end of the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, to 0.75%. However, the MPC emphasised again, that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but they declined to give a medium term forecast. They do not think that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. They also feel that the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Bank of England monetary policy takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. This is likely to lead to friction with the EU when setting the target for the fiscal deficit in the national budget. Unsurprisingly, investors have taken a dim view of this and so Italian bond yields have been rising.
- Austria, the Czech Republic and Hungary now form a strongly anti-immigration bloc within the EU while Italy, this year, has also elected a strongly anti-immigration government. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position as a result of the rise of the anti-immigration AfD party. To compound this, the result of the Swedish general election in September 2018 has left an anti-immigration party potentially holding the balance of power in forming a coalition government. The challenges from these political developments could put considerable pressure on the cohesion of the EU and could spill over into impacting the euro, EU financial policy and financial markets.
- The imposition of trade tariffs by President Trump could negatively impact world growth. President Trump's specific actions against Turkey pose a particular risk to its economy which could, in turn,

negatively impact Spanish and French banks which have significant exposures to loans to Turkey.

- Weak capitalisation of some European banks.
- Rising interest rates in the US could negatively impact emerging countries which have borrowed heavily in dollar denominated debt, so causing an investor flight to safe havens e.g. UK gilts.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- President Trump's fiscal plans to stimulate economic expansion causing a significant increase in inflation in the US and causing further sell offs of government bonds in major western countries.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

4. Treasury Management Strategy Statement and Annual Investment Strategy Update

The Treasury Management Strategy Statement (TMSS) for 2018/19, was approved by this Council on 1st March 2018.

There are no policy changes to the TMSS; the details in this report update the position in the light of the updated economic position and budgetary changes already approved.

5. The Council's Capital Position (Prudential Indicators)

This part of the report is structured to update:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

5.1 Prudential Indicator for Capital Expenditure

This table below shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

Capital Expenditure	2018/19 Original Estimate £m	Current Position £m	2018/19 Revised Estimate £m
Total capital expenditure	1.9	0.3	6.1

The variation between original and revised estimate is detailed as follows:

- A number of major new capital projects have been agreed since the budget was set, including the new leisure centre projects and Hertford Theatre builds with consultancy spend in 2018/19. (£1.5m)
- Herts and Essex loan. (£1m)
- Slippage from 2017/18 plus other minor variations (£1.7m).
-

5.2 Changes to the Financing of the Capital Programme

The table below draws together the main strategy elements of the capital expenditure plans (above), highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision). This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Capital Expenditure	2018/19 Original Estimate £m	Current Position £m	2018/19 Revised Estimate £m
Total capital expenditure	**1.9**	**0.3**	**6.1**
Financed by:			
Capital receipts	1.0	0.3	1.0
Capital grants	-	-	0.1
Capital reserves	-	-	-
Revenue	-	-	-
Total financing	**1.0**	**0.3**	**1.1**
Borrowing requirement	**0.9**	**-**	**5.0**

5.3 (CFR), External Debt and the Operational Boundary

The table below shows the CFR, which is the underlying external need to incur borrowing for a capital purpose. It also shows the expected debt position over the period, which is termed the Operational Boundary.

Prudential Indicator – Capital Financing Requirement

The original forecast Capital Financing Requirement is expected to increase by £5m due to additional capital expenditure approved by members since the 2018/19 budget was set.

Prudential Indicator – the Operational Boundary for external debt

	2018/19 Original Estimate £m	Current Position £m	2018/19 Revised Estimate £m
Prudential Indicator – Capital Financing Requirement			
Total CFR	(21.1)	(23.1)	(18.1)
Prudential Indicator – the Operational Boundary for external debt			
Borrowing	7.5	7.5	7.5
Other long term liabilities*	-	-	-
Total debt (year end position)	**7.5**	**7.5**	**7.5**

** On balance sheet PFI schemes and finance leases etc.*

5.4 Limits to Borrowing Activity

The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose*. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and next two financial years. This allows some flexibility for limited early borrowing for future years. The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent.

** The management of transferred debt should be excluded from net borrowing.*

	2018/19 Original	Current Position	2018/19 Revised

	Estimate £m	£m	Estimate £m
Borrowing	7.5	7.5	7.5
Other long term liabilities*	-	-	-
Total debt	7.5	7.5	7.5
CFR* (year end position)	(21.1)	(23.1)	(18.1)

* *Includes on balance sheet PFI schemes and finance leases etc.*

The Director of Finance reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt	2018/19 Original Indicator	Current Position	2018/19 Revised Indicator
Borrowing	11.5	7.5	11.5
Other long term liabilities*	1.0	-	1.0
Total	12.5	7.5	12.5

* *Includes on balance sheet PFI schemes and finance leases etc.*

6. Investment Portfolio 2018/19

In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. As shown by forecasts in section 3.2, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.75% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

The Council held £67m of investments as at 30th September 2018 (£66m at 31 March 2017), £20m of which is held in property funds and £47m in short term investments. The investment portfolio yield for the first 6 months of the year is 3.58% (property funds) 0.77% (short term) against an average 6mth benchmark return of 0.71%. (See Appendix 2)

The Chief Financial Officer confirms that the approved limits within the Annual Investment Strategy were not breached during the first 6 months of 2018/19.

The Council's budgeted investment return for 2018/19 is £1.090m, and performance for the year to date is in line with the budget.

Investment Counterparty criteria

The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

7. Borrowing

The Council's capital financing requirement (CFR) for 2018/19 is (£18.1m), negative. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions. The Council has a negative CFR position and external borrowings of £7.5m.

It is anticipated that further borrowing will not be undertaken during this financial year.

8. Debt Rescheduling

Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates, and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

£6m of the Council's £7.5m external borrowings mature in May 2020.

9. Other

1. UK banks – ring fencing

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

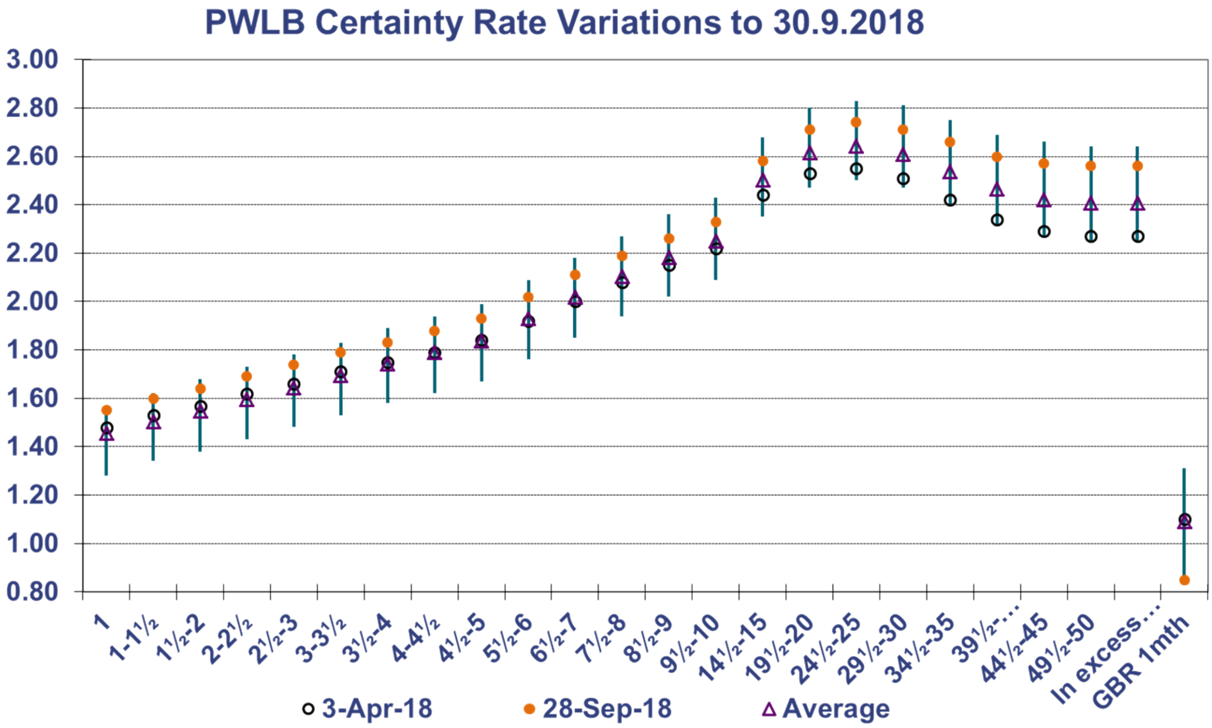
Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

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

2. Changes in risk appetite

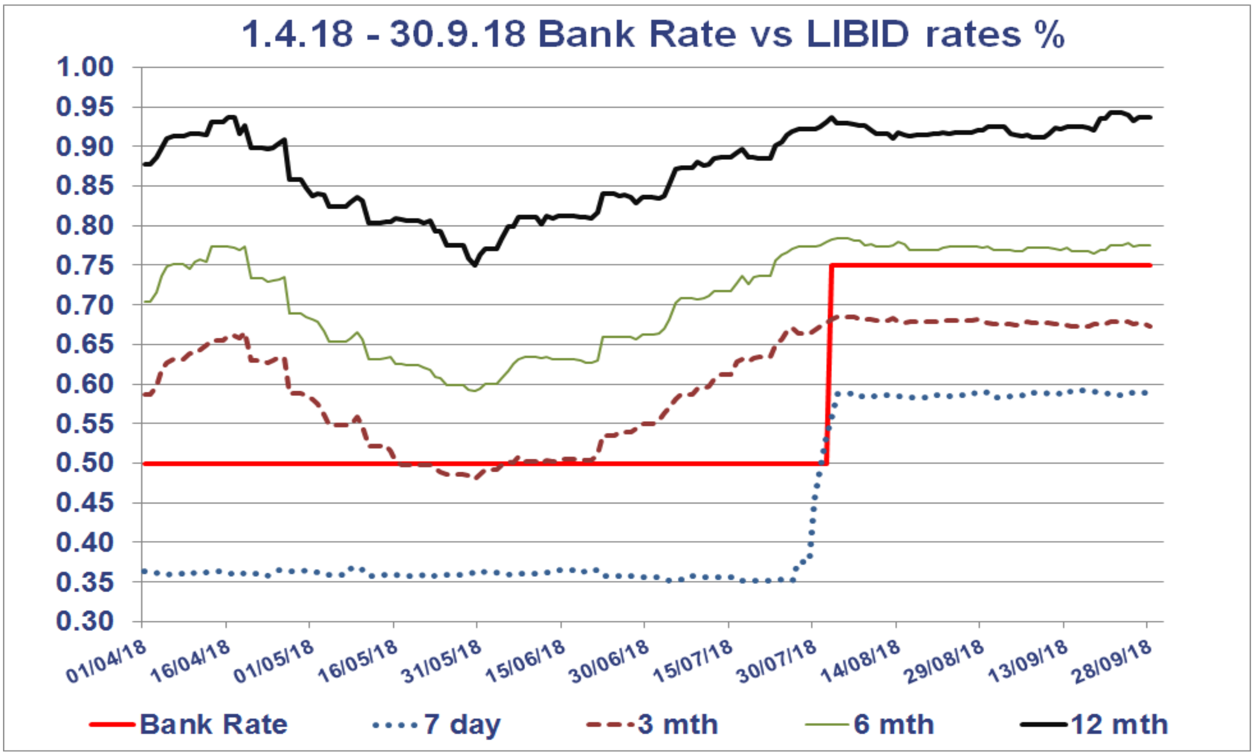
The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy should be brought to members' attention in treasury management update reports.

APPENDIX 1: Borrowing



APPENDIX 2: Investing

	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.75	0.59	0.60	0.68	0.78	0.94
High Date	02/08/2018	14/09/2018	18/09/2018	06/08/2018	03/08/2018	21/09/2018
Low	0.50	0.35	0.37	0.48	0.59	0.75
Low Date	01/04/2018	19/07/2018	30/05/2018	30/05/2018	30/05/2018	30/05/2018
Average	0.58	0.43	0.47	0.61	0.71	0.87
Spread	0.25	0.24	0.23	0.21	0.19	0.19



APPENDIX 3: Approved Countries for investments

Based on lowest available rating

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Hong Kong
- U.K.

AA-

- Belgium
- Qatar

N.B. This list is as at 30.09.18

CIPFA The Chartered Institute of Public Finance & Accountancy

Essential Reference Paper "C "

treasury management

in the Public Services

Code of Practice and Cross-Sectoral Guidance Notes

2017 Edition

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed. As the world's only professional accountancy body to specialise in public services, CIPFA's qualifications are the foundation for a career in public finance. We also champion high performance in public services, translating our experience and insight into clear advice and practical services. Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance.

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treasury management

in the Public Services

Code of Practice and Cross-Sectoral Guidance Notes

2017 Edition

Published by:

CIPFA \ THE CHARTERED INSTITUTE OF PUBLIC FINANCE AND ACCOUNTANCY

77 Mansell Street, London E1 8AN

020 7543 5600 \ customerservices@cipfa.org \ www.cipfa.org

ISBN 978 1 84508 495 0

Designed and typeset by Ministry of Design, Bath
(www.ministryofdesign.co.uk)

Contents

SECTION 1

Introduction

This *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes* (the Code) represents a revision of the 2011 Code.

This Code has been reviewed and updated following recent developments in the marketplace and the introduction of the Localism Act 2011 for English local authorities.

There is no universally agreed or formal definition of the public services. For the purposes of this Code and its accompanying guidance notes, public services have been taken to include those organisations which are, in terms of government expenditure classification, the public sector, together with certain other organisations which are materially reliant on government funding or subsidy, and/or have significant social, democratic or political influences on their activities.

Specifically, the Code and guidance notes have been designed to be primarily for the use of local, police and fire authorities, registered social landlords or registered providers of social housing under the social housing regulatory framework, higher and further education institutions, and the National Health Service.

Within these organisations, CIPFA recognises that there is a wide range of interpretations of what activities comprise treasury management. For the purposes of this Code and accompanying guidance notes, CIPFA has adopted the following as its definition of treasury management activities:

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

This definition is intended to apply to all public service organisations in their use of capital and project financings, borrowings and all investments.

There are substantial variations between different parts of the public services in the nature of and extent to which they employ treasury management activities and techniques in pursuit of their business and service objectives. These variations are primarily a function of the respective statutory and regulatory regimes under which they operate, the powers they possess in respect of treasury management, and the services and businesses they pursue. Nothing in this Code overrides or should be taken as overriding statutory provision. Nor does the Code make intra vires anything that is otherwise ultra vires.

'Investments' in the definition above covers all the financial assets of the organisation, as well as other non-financial assets which the organisation holds primarily for financial returns, such as investment property portfolios. This may therefore include investments which are not managed as part of normal treasury management or under treasury management delegations. All investments require an appropriate investment management and risk management framework under this Code.

The essentially more commercial nature of some public service organisations has the potential to create pressures and perhaps conflicts in their treasury management activities. These differences are explained more fully in the sector-specific guidance notes, however the key principle of control of risk and optimising returns consistent with the organisation's risk appetite should be applied across all investment activities, including more commercially based investments.

CIPFA recognises that many organisations will find that certain parts of this publication are not relevant to the scope and nature of their treasury management activities. It believes, however, that the recommendations made in the Code provide a basis for all public service organisations to create clear treasury management objectives and to structure and maintain sound treasury management policies and practices.

The guidance notes serve three functions:

- First, they provide general background and explanatory information on the issues raised and recommendations made in the Code.
- Second, they give suggestions for schedules to accompany the Code's recommended treasury management practices.
- Third, they draw attention to features of treasury management that are particular to those individual parts of the public services covered by the Code.

CIPFA gratefully acknowledges the contributions made by the many organisations and individuals who assisted during the preparation of the Code and guidance notes. Responsibility for their contents rests solely with CIPFA, **and they should not be relied on by any third party in their treasury management dealings with public service organisations, nor as an authoritative interpretation of law.**

While the Code has wide-ranging support of various bodies, the **application and maintenance of these recommendations is the responsibility of the organisations themselves.**

SECTION 2

Purposes

CIPFA has produced this Code and the accompanying guidance notes to help satisfy nine main purposes:

1 To assist public service organisations in the development and maintenance of firm foundations and clear objectives for their treasury management activities, and thereby to add to their credibility in the public eye.

2 To emphasise the overriding importance of effective risk management as the foundation for treasury management in all public service bodies.

3 To provide transparency for treasury management decisions including the use of counterparties and financial instruments that individual public service organisations intend to use for the prudent management of their financial affairs.

4 To encourage the pursuit of value for money in treasury management, and to promote the reasoned use, development and appreciation of appropriate and practical measures of performance.

5 To enable CIPFA members to fulfil their professional and contractual responsibilities to the organisations they serve and, in accordance with the members' charter, "*to maintain and develop the professional competence of both themselves and those they supervise*".

6 To help facilitate a standardisation and codification of treasury management policies and practices in the public services.

7 To assist those involved in the regulation and review of treasury management in the public services, particularly those charged with the audit of the same.

8 To foster a continuing debate on the relevance and currency of the statutory and regulatory regimes under which treasury management in the various parts of the public services operates.

9 To further the understanding and confidence of, and to act as a reference work for, financial and other institutions whose businesses bring them into contact with the treasury management activities of public service organisations.

SECTION 3
Status

The Code has the support of a wide range of organisations.

In the case of local authorities in England and Wales, the Code has a particular significance under the provisions of the Local Government Act 2003. This requires local authorities *"to have regard (a) to such guidance as the Secretary of State may issue, and (b) to such other guidance as the Secretary of State may by regulations specify"*. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 in paragraph 24 require local authorities to have regard to this guidance. In Scotland, Finance Circular 5/2010[1] requires local authorities to *have regard* to the Code.

The Local Government Association has expressed strong support for the Treasury Management Code. It is encouraging the good practice set out in the Code.

The Chartered Institute of Housing is happy to support the Treasury Management Code, recognising that it is suitable for adoption by local authorities as housing owners and managers, their arm's-length management organisations and housing associations.

The recommendations in the Code are similarly relevant to cash handled in respect of an organisation's pension fund, trust or endowment fund cash.

Nothing in this Code overrides or should be taken as overriding statutory provision. Nor does the Code make intra vires anything that is otherwise ultra vires.

The Code applies to all organisations that have adopted it as part of their standing orders, financial regulations or other formal policy documents appropriate to their circumstances.

CIPFA recognises that some organisations may not find the Code's recommended or proposed forms of wording to be precisely suitable to their circumstances. An organisation may, where it can justify doing so, make alterations to the recommended or proposed wording without adversely affecting its stated adoption of the Code, so long as, when taken as a whole, those alterations do not result in an organisation materially deviating from the Code's key principles as described in Section 4.

The accompanying guidance notes include explanations of the Code's recommendations and contain supporting suggestions. They are not prescriptive.

In April 2017 the Bank of England introduced a UK Money Markets Code that supersedes and substantively updates the Non-Investment Products Code (NIPs Code) and other earlier guidance. It has been drawn up by a wide cross-section of market practitioners in a sub-group of the Bank of England's Money Markets Committee. Like its predecessor, the new Code, which is market guidance, has no statutory underpinning; and there are no arrangements for

1. Finance Circular 5/2010 The Investment of Money by Scottish Local Authorities (The Scottish Government, 2010).

supervision or enforcement. CIPFA commends the UK Money Markets Code to its members as good practice to which they should adhere. Copies of the UK Money Markets Code can be obtained from the Bank of England's website.

Key principles

This Code identifies three key principles.

KEY PRINCIPLE 1

Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

KEY PRINCIPLE 2

Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and portfolio liquidity when investing treasury management funds.

KEY PRINCIPLE 3

They should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

In framing these recommendations, CIPFA acknowledges the difficulties of striving for effective risk management and control, while at the same time pursuing value for money. This Code does not seek to be prescriptive about how this issue should be handled, particularly since it covers such a wide variety of organisations. However, where appropriate, the sector-specific guidance notes give suitable advice. CIPFA recognises that no two organisations in the public services are likely to tackle this issue in precisely the same manner; but success in this area of treasury management is likely to be viewed, especially in value for money terms, as an indicator of a strongly performing treasury management function.

It is CIPFA's view that throughout the public services the priority for treasury management is to protect capital rather than to maximise return. The avoidance of all risk is neither appropriate nor possible. However, a balance must be struck with a keen responsibility for public money.

SECTION 5

Clauses to be formally adopted

CIPFA recommends that all public service organisations adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances, the following four clauses.

1 This organisation will create and maintain, as the cornerstones for effective treasury management:

   - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
   - suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

   The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Code's key principles.

2 This organisation (ie full board/council) will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

3 This organisation delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to [note 1], and for the execution and administration of treasury management decisions to [note 2], who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

4 This organisation nominates [note 3] to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Note 1: name of responsible body (for example, committee, board or council) or nominated group of individuals or relevant committee such as cabinet or executive. Where a capital strategy is produced by a local authority this may include the setting of detailed treasury management policies, while being clear that overall responsibility remains with full council.

Note 2: title of responsible officer (for the purposes of this Code, the term 'responsible officer' has been used, although it is recognised that, in practice, many different terms exist). For example in higher education, the vice-chancellor/principal or equivalent is the 'designated officer' who will ensure that the governing body complies with all terms and conditions of funding provided by the funding body. However it is usual for day-to-day financial management to be delegated to a director of finance who will take professional responsibility for such areas of an institution's work and this is the officer who is referred to here.

Note 3: name of responsible body (for example, committee, board or council) or nominated group of individuals or relevant committee such as audit committee or relevant scrutiny committee.

SECTION 6

The treasury management policy statement

CIPFA recommends that an organisation's treasury management policy statement adopts the following forms of words to define the policies and objectives of its treasury management activities:

1 This organisation defines its treasury management activities as:
The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

2 This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

3 This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

The policy statement should include the organisation's high level policies for borrowing and investments.

SECTION 7
Treasury management practices

CIPFA recommends that an organisation's treasury management practices (TMPs) include those of the following that are relevant to its treasury management powers and the scope of its treasury management activities:

TMP1	Risk management
TMP2	Performance measurement
TMP3	Decision making and analysis
TMP4	Approved instruments, methods and techniques
TMP5	Organisation, clarity and segregation of responsibilities, and dealing arrangements
TMP6	Reporting requirements and management information arrangements
TMP7	Budgeting, accounting and audit arrangements
TMP8	Cash and cash flow management
TMP9	Money laundering
TMP10	Training and qualifications
TMP11	Use of external service providers
TMP12	Corporate governance

It is expected that the following forms of words will be suitably amended to reflect an organisation's particular circumstances in defining its TMPs. Specific details of the systems and routines to be employed and the records to be maintained should take the form of schedules to their TMPs. Suggestions on the detail of what might be included in these schedules are given in the accompanying guidance notes.

General background information about each of the above practices, and the particular circumstances of each part of the public services covered by this Code, is also given in the guidance notes.

The nature and extent of the involvement of an organisation's responsible body in approving and monitoring its TMPs and accompanying schedules is a matter for local decision. CIPFA recognises that in some organisations this may be delegated to the responsible officer. In all cases it should be subjected to scrutiny by the responsible body following recommendations by the responsible officer.

TMP1 RISK MANAGEMENT

General statement

This organisation regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that robust due diligence procedures cover all external investment.

The responsible officer will design, implement and monitor all arrangements for the identification, management and control of treasury management risk, will report at least annually on the adequacy/suitability thereof, and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the organisation's objectives in this respect, all in accordance with the procedures set out in TMP6 *Reporting requirements and management information arrangements*.

In respect of each of the following risks, the arrangements which seek to ensure compliance with these objectives are set out in the schedule to this document.

[1] credit and counterparty risk management

This organisation will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with whom funds may be deposited, and will limit its treasury management investment activities to the instruments, methods and techniques referred to in TMP4 *Approved instruments, methods and techniques* and listed in the schedule to this document. It also recognises the need to have, and will therefore maintain, a formal counterparty policy in respect of those organisations from which it may borrow, or with whom it may enter into other financing or derivative arrangements.

[2] liquidity risk management

This organisation will ensure it has adequate though not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives.

This organisation will only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities.

[3] interest rate risk management

This organisation will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements as amended in accordance with TMP6 *Reporting requirements and management information arrangements*.

It will achieve this by the prudent use of its approved instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates. This should be subject to the consideration and, if required, approval of any policy or budgetary implications.

It will ensure that any hedging tools such as derivatives are only used for the management of risk and the prudent management of financial affairs and that the policy for the use of derivatives is clearly detailed in the annual strategy.

[4] exchange rate risk management

It will manage its exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income/expenditure levels.

[5] inflation risk management

The organisation will keep under review the sensitivity of its treasury assets and liabilities to inflation, and will seek to manage the risk accordingly in the context of the whole organisation's inflation exposures.

[6] refinancing risk management

This organisation will ensure that its borrowing, private financing and partnership arrangements are negotiated, structured and documented, and the maturity profile of the monies so raised is managed, with a view to obtaining offer terms for renewal or refinancing, if required, which are competitive and as favourable to the organisation as can reasonably be achieved in the light of market conditions prevailing at the time.

It will actively manage its relationships with its counterparties in these transactions in such a manner as to secure this objective, and will avoid overreliance on any one source of funding if this might jeopardise achievement of the above.

[7] legal and regulatory risk management

This organisation will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities. In framing its credit and counterparty policy under TMP1[1] *credit and counterparty risk management*, it will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the transactions they may effect with the organisation, particularly with regard to duty of care and fees charged.

This organisation recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the organisation.

[8] fraud, error and corruption, and contingency management

This organisation will ensure that it has identified the circumstances which may expose it to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings. Accordingly, it will employ suitable systems and procedures, and will maintain effective contingency management arrangements, to these ends.

[9] price risk management

This organisation will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests, and will accordingly seek to protect itself from the effects of such fluctuations.

TMP2 PERFORMANCE MEASUREMENT

This organisation is committed to the pursuit of value for money in its treasury management activities, and to the use of performance methodology in support of that aim, within the framework set out in its treasury management policy statement.

Accordingly, the treasury management function will be the subject of ongoing analysis of the value it adds in support of the organisation's stated business or service objectives. It will be the subject of regular examination of alternative methods of service delivery, of the availability of fiscal or other grant or subsidy incentives, and of the scope for other potential improvements. The performance of the treasury management function will be measured using the criteria set out in the schedule to this document.

TMP3 DECISION MAKING AND ANALYSIS

This organisation will maintain full records of its treasury management decisions, and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past, and for demonstrating that reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at the time. The issues to be addressed and processes and practices to be pursued in reaching decisions are detailed in the schedule to this document.

TMP4 APPROVED INSTRUMENTS, METHODS AND TECHNIQUES

This organisation will undertake its treasury management activities by employing only those instruments, methods and techniques detailed in the schedule to this document, and within the limits and parameters defined in TMP1 *Risk management*.

Where this organisation intends to use derivative instruments for the management of risks, these will be limited to those set out in its annual treasury strategy. The organisation will seek proper advice and will consider that advice when entering into arrangements to use such products to ensure that it fully understands those products.

This organisation has reviewed its classification with financial institutions under MIFID II and has set out in the schedule to this document those organisations with which it is registered as a professional client and those with which it has an application outstanding to register as a professional client.

TMP5 ORGANISATION, CLARITY AND SEGREGATION OF RESPONSIBILITIES, AND DEALING ARRANGEMENTS

This organisation considers it essential, for the purposes of the effective control and monitoring of its treasury management activities, for the reduction of the risk of fraud or error, and for the pursuit of optimum performance, that these activities are structured and managed in a fully integrated manner, and that there is at all times a clarity of treasury management responsibilities.

The principle on which this will be based is a clear distinction between those charged with setting treasury management policies and those charged with implementing and controlling these policies, particularly with regard to the execution and transmission of funds, the recording and administering of treasury management decisions, and the audit and review of the treasury management function.

If and when this organisation intends, as a result of lack of resources or other circumstances, to depart from these principles, the responsible officer will ensure that the reasons are properly reported in accordance with TMP6 *Reporting requirements and management information arrangements*, and the implications properly considered and evaluated.

The responsible officer will ensure that there are clear written statements of the responsibilities for each post engaged in treasury management, and the arrangements for absence cover. The responsible officer will also ensure that at all times those engaged in treasury management will follow the policies and procedures set out. The present arrangements are detailed in the schedule to this document.

The responsible officer will ensure there is proper documentation for all deals and transactions, and that procedures exist for the effective transmission of funds. The present arrangements are detailed in the schedule to this document.

The delegations to the responsible officer in respect of treasury management are set out in the schedule to this document. The responsible officer will fulfil all such responsibilities in accordance with the organisation's policy statement and TMPs and, if a CIPFA member, the *Standard of Professional Practice on Treasury Management*.

TMP6 REPORTING REQUIREMENTS AND MANAGEMENT INFORMATION ARRANGEMENTS

This organisation will ensure that regular reports are prepared and considered on the implementation of its treasury management policies; on the effects of decisions taken and transactions executed in pursuit of those policies; on the implications of changes, particularly budgetary, resulting from regulatory, economic, market or other factors affecting its treasury management activities; and on the performance of the treasury management function.

As a minimum:

- The organisation (ie full board/council) will receive:
  - an annual report on the strategy and plan to be pursued in the coming year
  - a mid-year review

  - an annual report on the performance of the treasury management function, on the effects of the decisions taken and the transactions executed in the past year, and on any circumstances of non-compliance with the organisation's treasury management policy statement and TMPs.

- The board/council, or the committee to which some treasury management responsibilities are delegated, will receive regular monitoring reports on treasury management activities and risks.
- The body responsible for scrutiny, such as an audit or scrutiny committee, will have responsibility for the scrutiny of treasury management policies and practices.
- Local authorities should report the treasury management indicators as detailed in their sector-specific guidance notes.

The present arrangements and the form of these reports are detailed in the schedule to this document.

TMP7 BUDGETING, ACCOUNTING AND AUDIT ARRANGEMENTS

The responsible officer will prepare, and this organisation will approve and, if necessary, from time to time will amend, an annual budget for treasury management, which will bring together all of the costs involved in running the treasury management function, together with associated income. The matters to be included in the budget will at minimum be those required by statute or regulation, together with such information as will demonstrate compliance with TMP1 *Risk management*, TMP2 *Performance measurement*, and TMP4 *Approved instruments, methods and techniques*. The responsible officer will exercise effective controls over this budget, and will report upon and recommend any changes required in accordance with TMP6 *Reporting requirements and management information arrangements*.

This organisation will account for its treasury management activities, for decisions made and transactions executed, in accordance with appropriate accounting practices and standards, and with statutory and regulatory requirements in force for the time being.

TMP8 CASH AND CASH FLOW MANAGEMENT

Unless statutory or regulatory requirements demand otherwise, all monies in the hands of this organisation will be under the control of the responsible officer, and will be aggregated for cash flow and investment management purposes. Cash flow projections will be prepared on a regular and timely basis, and the responsible officer will ensure that these are adequate for the purposes of monitoring compliance with TMP1[2] *liquidity risk management*. The present arrangements for preparing cash flow projections, and their form, are set out in the schedule to this document.

TMP9 MONEY LAUNDERING

This organisation is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure that staff involved in this are properly trained. The present arrangements, including the name of the officer to whom reports should be made, are detailed in the schedule to this document.

TMP10 TRAINING AND QUALIFICATIONS

This organisation recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The responsible officer will recommend and implement the necessary arrangements.

The responsible officer will ensure that board/council members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.

Those charged with governance recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively.

The present arrangements are detailed in the schedule to this document.

TMP11 USE OF EXTERNAL SERVICE PROVIDERS

This organisation recognises that responsibility for treasury management decisions remains with the organisation at all times. It recognises that there may be potential value in employing external providers of treasury management services, in order to acquire access to specialist skills and resources. When it employs such service providers, it will ensure it does so for reasons which have been submitted to a full evaluation of the costs and benefits. It will also ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review. And it will ensure, where feasible and necessary, that a spread of service providers is used, to avoid overreliance on one or a small number of companies. Where services are subject to formal tender or re-tender arrangements, legislative requirements will always be observed. The monitoring of such arrangements rests with the responsible officer, and details of the current arrangements are set out in the schedule to this document.

TMP12 CORPORATE GOVERNANCE

This organisation is committed to the pursuit of proper corporate governance throughout its businesses and services, and to establishing the principles and practices by which this can be achieved. Accordingly, the treasury management function and its treasury management activities will be undertaken with openness and transparency, honesty, integrity and accountability.

This organisation has adopted and has implemented the key principles of the Code.
This, together with the other arrangements detailed in the schedule to this document, is considered vital to the achievement of proper corporate governance in treasury management,

and the responsible officer will monitor and, if and when necessary, report upon the effectiveness of these arrangements.

SECTION 8

Investments that are not part of treasury management activity

Where, in addition to treasury management investment activity, organisations invest in other financial assets and property primarily for financial return, these investments should be proportional to the level of resources available to the organisation and the organisation should ensure that the same robust procedures for the consideration of risk and return are applied to these decisions.

MANAGEMENT PRACTICES FOR NON-TREASURY INVESTMENTS

This organisation recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes, requires careful investment management. Such activity includes loans supporting service outcomes, investments in subsidiaries, and investment property portfolios.

This organisation will ensure that all the organisation's investments are covered in the capital strategy, investment strategy or equivalent, and will set out, where relevant, the organisation's risk appetite and specific policies and arrangements for non-treasury investments. It will be recognised that the risk appetite for these activities may differ from that for treasury management.

The organisation will maintain a schedule setting out a summary of existing material investments, subsidiaries, joint ventures and liabilities including financial guarantees and the organisation's risk exposure.

Cross-Sectoral Guidance Notes

Introduction

These guidance notes accompany CIPFA's *Treasury Management in the Public Services: Code of Practice* (the Code), and should be read in conjunction with it. They are divided into three sections and serve the following purposes:

1 Section 1 provides background and explanatory notes on the main issues raised and the key principles stated in the Code.

2 Section 2 proposes the contents of schedules to accompany the statement of an organisation's treasury management practices (TMPs), which the Code recommends every public service organisation should have.

3 Section 3 provides further guidance on investment in other financial assets and property primarily for financial return that is not part of treasury management activity.

Responsibility for the guidance in this document and the views expressed in it rests solely with CIPFA. It should not be relied upon by any third party in dealings with public service organisations, nor should it be relied upon as an authoritative interpretation of the law.

CIPFA wishes to thank the members of its Treasury Management Panel, who have overseen the updating of these guidance notes.

SECTION 1

Background and explanatory notes

The Code recommends that:

KEY PRINCIPLE 1

Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

KEY PRINCIPLE 2

Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and portfolio liquidity when investing treasury management funds.

KEY PRINCIPLE 3

They should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

Source: The Code – Key Principles

The Code further recommends the adoption of four key clauses and the preparation of a treasury management policy statement and treasury management practices in order to achieve the above.

This section of the guidance notes explains the reasons for CIPFA's recommendations, and expands on the specific proposals concerning an organisation's approved treasury management practices.

1.1 RISK MANAGEMENT

The Code acknowledges the substantial variations that exist between different parts of the public services in the nature of and extent to which they employ treasury management activities and techniques in pursuit of their business and service objectives. These variations are primarily a function of the respective statutory and regulatory regimes under which organisations operate, the powers they possess in respect of treasury management, and the services and businesses they pursue.

The Code states, however, that in CIPFA's view, the common and overriding aim of such organisations should be the effective identification, monitoring and control of risk. The Code recommends strongly that organisations' treasury management policies and practices reflect this belief, and this message is further reinforced in this section of the guidance notes.

Some public service organisations may use derivatives for the management of risk; where this is the case public service organisations should satisfy themselves that they understand fully how underlying risks are affected and any additional risks that may result.

The Code identifies nine main treasury management risks. These guidance notes define these risks as follows:

Credit and counterparty risk

The risk of failure by a counterparty to meet its contractual obligations to the organisation under an investment, borrowing, capital, project or partnership financing, particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources.

Liquidity risk

The risk that cash will not be available when it is needed, that ineffective management of liquidity creates additional unbudgeted costs, and that the organisation's business/service objectives will be thereby compromised.

Interest rate risk

The risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately.

Exchange rate risk

The risk that fluctuations in foreign exchange rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately.

Inflation risk

Inflation risk, also called purchasing power risk, is the chance that the cash flows from an investment won't be worth as much in the future because of changes in purchasing power due to inflation.

Refinancing risk

The risk that maturing borrowings, capital, project or partnership financings cannot be refinanced on terms that reflect the provisions made by the organisation for those refinancings, both capital and current (revenue), and/or that the terms are inconsistent with prevailing market conditions at the time.

Legal and regulatory risk

The risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly.

Fraud, error and corruption, and contingency management

The risk that an organisation fails to identify the circumstances in which it may be exposed to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings, and fails to employ suitable systems and procedures and maintain effective contingency management arrangements to these ends. It includes the area of risk commonly referred to as operational risk.

Price risk

The risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately.

Managing treasury management risks

CIPFA believes that the substantial majority of public service organisations embody within their business or service planning processes the means by which they can identify treasury management risks. It also believes that many are familiar with and have implemented methods by which those risks can be successfully managed and contained. If an organisation is not so doing, it is unlikely to be treating the subject of risk management with sufficient priority.

For an organisation to manage and contain its risks successfully, it must first identify what they might be, and consider to what extent it is able and prepared to suffer the consequences of those risks impacting adversely on its finances. To the extent that it is unable or unprepared to bear those consequences, it should be seeking to protect itself against that eventuality.

As part of its business or service planning processes, an organisation needs to put in place the following:

- **well documented records of the standing of counterparties it does or may deal with, and continuous access to independent sources of advice and information on the same**

All public service organisations need to be alert to the prospect of the counterparties they deal with being unable or unwilling to fulfil their contractual responsibilities, especially as a result of failure to maintain their credit status. This applies not only to contracts relating to capital financing and investment, but also to those concerned with the increasing reliance placed by public service organisations on outsourcing.

Organisations should clearly specify the minimum acceptable credit quality of their counterparties. This should be monitored regularly through the published credit ratings (where available) for both the institution and the country of investment. Organisations should be aware of the differences in how they are rated, what is being measured by each agency and any forward-looking rating warnings.

Know your counterparty is a key principle; organisations should not rely on credit ratings alone for their understanding of counterparties. Credit ratings remain a key source of information but it is important to recognise that they do have limitations. Organisations are advised to have regard to the ratings issued by the main agencies and to make their decisions based on all ratings. Ratings should be kept under regular review and 'ratings watch' notices acted upon.

Credit ratings should only be used as a starting point when considering credit risk. Organisations should make use of generally available market information, such as the quality financial press, market data and information on government support for banks, including the ability and willingness of the relevant government to provide adequate support.

As a general rule, however, organisations need a sound diversification policy with high credit quality counterparties. Such a policy is needed to prevent overreliance on a small number of counterparties and should also consider country, sector and group limits.

- **an effective cash and cash flow forecasting and monitoring system which will identify the extent to which the organisation is exposed to the effects of potential cash flow variations and shortfalls**

For most public service organisations, the prospect of an ongoing liquidity shortage is remote. Such is the nature of their income sources that they are generally more involved with the effective management of surplus liquidity than with concerns over cash flow difficulties. That said, organisations should be mindful of the additional cost implications of unanticipated borrowing for the short term.

It is for each organisation to determine what resources to devote to the forecasting and monitoring of its cash balances and to managing the investment of its surplus liquidity, not only in the light of its own circumstances, but also within the context of the statutory and regulatory regimes applying to its treasury management activities.

The minimum requirement should be that the organisation's liquidity targets are secured, and for this reason alone, every public service organisation should strive for reliability and accuracy in its cash flow forecasting and monitoring. An organisation that decides to devote substantially more resources than necessary to achieve this will need to be in a position to make a reasoned judgement as to whether the cost of those resources is warranted by the beneficial effect it secures on its investment returns.

Section 1.8 of these guidance notes provides further guidance on the management of cash and cash flows.

- **access to financial market commentaries and reviews on the likely future courses of interest rates, exchange rates and inflation, to enable it to assess future treasury**

risks and scenarios, and to permit the effective management and control and development of suitable risk management strategies

Public service organisations are subject to exposures to fluctuations in interest rates and exchange rates. A common requirement, however, is for organisations to define their policies and practices in order to deliver the necessary degree of certainty for their plans and budgets. At the same time, however, they need to understand how fluctuations in market conditions impact upon yields and allow sufficient flexibility both to take advantage of potentially advantageous changes in market conditions and to mitigate the effects of potentially disadvantageous changes.

An organisation's treasury management strategy should detail how this risk is being addressed. Should interest rates not follow their likely course then this should be reported during the year. The annual treasury strategy should not need updating.

The trade-off between certainty and flexibility is very much a matter of individual choice, within whatever statutory or regulatory framework exists. Public service organisations need to be aware of the potential costs and benefits of those choices. Access to external sources of data and analysis can be an essential ingredient of making informed decisions. The credibility of the sources used is likely to be greater if it can be demonstrated that they are unbiased and not susceptible to conflicts of interest.

Where an organisation seeks to manage its exposures to interest rate or exchange rate fluctuations by the use of specific financial instruments such as derivatives, it should be clear about its policies in its annual strategy. It should only use such instruments for the prudent management of its financial affairs and should fully understand the instruments and the risks it is managing.

- **reliable records and forecasts of the terms and the maturities of its borrowings, capital, project and partnership funding, to allow it to plan the timing of, and successfully negotiate appropriate terms for, its refinancings**

Uncertainty over market conditions at times of renegotiating or replacing borrowings or other market financings is an inevitable consequence of the need for most public service organisations to raise long-term funding. This uncertainty can be reduced, however, if an organisation ensures it has reliable records of its maturities and allows itself time to plan well in advance of its need to negotiate. The effective management and, in particular, the avoidance of a bunching in its maturities can reduce the prospect of having to negotiate at a time that is unfavourable to the organisation. Where an organisation provides financial guarantees to third parties, these should be included in these records and regularly reassessed as to the probability they will be called upon.

- **comprehensive documentation of the organisation's own legal powers and regulatory requirements, and of those of its counterparties, to allow it to assess the potential for illegal or irregular dealings in its treasury management activities**

Instances of public service organisations exceeding their legal powers or contravening regulatory controls are rare, since they are almost invariably prescribed very precisely. On the occasions this has occurred, however, the implications have usually been serious, and the problems so created have proved difficult to resolve, especially where they have involved commercial counterparties. It remains essential, therefore, that organisations maintain and make access widely available to up-to-date records of their powers and of the regulatory regime under which they undertake their treasury management activities. They should confirm, if requested to do so by counterparties, the powers and authorities under which they effect transactions with them. Equally importantly, they should question and establish the powers of those with whom they enter into transactions.

- **full analysis and records of the processes pursued in making treasury management decisions, and in executing transactions, to enable an organisation to create a successful audit trail, and to allow it to assess the need for contingency arrangements**

Sections 1.5 and 1.6 of these guidance notes draw attention to the need for clarity of organisation, reporting arrangements and management information systems and controls. As a natural extension of these, the requirement to demonstrate openness and accountability in their treasury management activities demands that public service organisations create and maintain an audit trail of their treasury management decisions and transactions. This is necessary not only to minimise the risk of being challenged over whether they pursued due processes, but also to help meet unforeseen events. These will include back-up measures to cope with staff absences and the destruction of treasury management records, as well as effecting suitable insurance arrangements. All of these need to be kept up to date. Further guidance on the issues to be considered when making treasury management decisions is given in Section 1.3 of these guidance notes.

- **comprehensive records of an organisation's contractual responsibilities and liabilities under treasury management contracts with counterparties, to enable it to fulfil its obligations thereunder**

Maintaining good working relationships with counterparties can be a vital way of ensuring the smooth running of an organisation's treasury management function. This relates not only to ensuring that timely and accurate payments are made under agreements, but also to good housekeeping matters such as the production of information and accounts.

- **reliable information about the potential for fluctuations in the market value of its investments, borrowings, derivatives and other financings, to allow an informed assessment of the potential for capital growth or capital reduction**

The maintenance of the capital value of their funds, and the effective control of any liabilities that may be subject to market fluctuations, should be high priorities for every public service organisation. Taxation issues are frequently difficult to evaluate and quantify, and can have significant consequences for the activities of some public service organisations. Control over these issues demands that organisations have a complete understanding of those treasury management instruments and techniques which are subject to market fluctuations prior to their being used. They should maintain full records of transactions, track actual and potential movements in values, and be familiar with the methods available to limit any potential losses.

When undertaking reviews of risk it is important for an organisation to consider any optionality it may have in relation to its investments or borrowings, ie any instruments which have built-in options for borrowers or lenders. For example, the repayment of a loan arising through the exercise of a Lender's Option, Borrower's Option (LOBO) agreement could alter an organisation's exposure to liquidity, interest rate, refinancing or market risk.

1.2 PERFORMANCE MEASUREMENT IN THE PUBLIC SERVICES

CIPFA advocates the principle that all public service organisations should create appropriate methods by which the performance of their treasury management activities can be measured. They can thereby help to judge whether they are gaining value for money from the resources devoted to these activities, particularly in meeting their wider business and service objectives.

CIPFA recognises the difficulties organisations face in achieving an appropriate balance between risk containment and value for money, but believes that the overriding need for effective risk management should be reflected in their treasury management policy statement and treasury management practices.

Performance measurement is a process designed to calculate the effectiveness of a portfolio's or manager's investment returns or borrowing costs, and the application of the resulting data for the purposes of comparison with the performance of other portfolios or managers, or with recognised industry standards or market indices.

The benefits and applications of performance measurement in the public services include:

1. using past experience beneficially to future treasury management policies and practices
2. by developing an appreciation of the factors influencing performance, improving the future processes of treasury decision making
3. allowing organisations to assess the potential for adding value through changes to the existing ways in which a portfolio is managed
4. demonstrating an awareness of the need to review regularly the value attached to the treasury management function, and enhancing accountability
5. enhancing the information available to organisations when seeking to review an existing manager's performance or when selecting a new manager
6. permitting an informed judgement and decision about the merits or otherwise of using new treasury management instruments or techniques.

These guidance notes are not intended as a comprehensive guide to the subject of performance measurement in the public services. However, the following general points may serve to assist organisations to avoid some of the most frequently encountered difficulties. CIPFA stresses the need for organisations to be aware of the possibly considerable costs involved in performance measurement and to evaluate the justification for incurring those costs in the context of the potential benefits.

The selection of appropriate measures and benchmarks is critical to securing value from performance measurement. Their precise nature and construction needs to be fully understood to reduce the likelihood of reaching misleading conclusions and, therefore, making ill-informed decisions. All benchmarking should consider risk as well as return. For example, when selecting appropriate measures by which to judge the investment performance of a cash investment portfolio, there are merits in selecting market indices that closely match the organisation's own cash investment and risk profiles. Alternatively, it may be useful to compare performance with indices that demonstrate the performance the organisation might have expected to achieve had it handled its investment activities differently, especially to judge the relative benefits of passive and active investment management.

Caution should be applied when analysing the performance of other organisations as it is important to establish whether the characteristics of their treasury management activities are truly comparable. It is misleading, for example, to draw conclusions about the respective performances of different organisations without first establishing the positions they take with regard to risk, since this can materially influence investment performance. It is similarly unhelpful to make comparisons between the performance of investment funds that are internally managed and those that are invested by firms of external investment managers. The latter are frequently able to make longer-term investment decisions, whereas the former often deal only with peaks and troughs of the organisation's cash flows.

CIPFA supports the use of risk benchmarks in measuring treasury management performance.[2]

1.3 DECISION MAKING AND ANALYSIS IN THE PUBLIC SERVICES

CIPFA considers it vital that the treasury management decisions of organisations in the public services should be subjected to prior scrutiny. The treasury management strategy is approved annually by full board/council, which is a strength. The treasury management strategy should be supplemented by the provision of monitoring information and regular review by board members/councillors in both executive and scrutiny functions. It also believes that records should be kept of the processes and the rationale behind those decisions. This is necessary not only for the purpose of allowing a historical assessment of the effectiveness of such decisions, but also as a means of ensuring that appropriate checks and safeguards are in place in the event, for example, of it becoming necessary to demonstrate the legality or probity of transactions. However, in determining the records to be kept, realism is needed to avoid creating a system that may overburden resources and outweigh the potential benefits.

The nature and scope of a particular organisation's treasury management function will determine the precise issues to be considered in reaching treasury management decisions, and the analysis and the methodology to be applied.

However, CIPFA gives the following general guidance on the issues to be considered in connection with various aspects of an organisation's treasury management activities, and which an organisation should demonstrate it has considered.

In respect of every decision made the organisation should:

- above all, be clear about the nature and extent of the risks to which the organisation may become exposed
- be certain about the legality of the decision reached and the nature of the transaction, and that all authorities to proceed have been obtained
- be content that the documentation is adequate both to deliver the organisation's objectives and protect the organisation's interests, and to deliver good housekeeping
- ensure that relevant due diligence has taken place

2 *Better Benchmarking for High Performance* (CIPFA, 2010)

- ensure that counterparties are judged satisfactory in the context of the organisation's creditworthiness policies, and that limits have not been exceeded
- be content that the terms of any transactions have been fully checked against the market, and have been found to be competitive.

In respect of borrowing and other funding decisions, the organisation should:

- consider the ongoing revenue liabilities created, and the implications for the organisation's future plans and budgets
- evaluate the economic and market factors that might influence the manner and timing of any decision to fund
- consider the merits and demerits of alternative forms of funding, including funding from revenue, leasing and private partnerships
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use and, if relevant, the opportunities for foreign currency funding.

In respect of investment decisions, the organisation should:

- consider the risks to capital and returns and the implications for the organisation's future plans and budgets
- consider the optimum period, in the light of cash flow availability and prevailing market conditions
- consider the alternative investment products and techniques available, especially the implications of using any which may expose the organisation to changes in the value of its capital.

In respect of decisions regarding derivatives, the organisation should:

- be able to demonstrate that the derivative transaction has reduced the organisation's overall exposure to treasury risks.

1.4 APPROVED INSTRUMENTS, METHODS AND TECHNIQUES

CIPFA's recommended wording of an organisation's treasury management practices makes clear the importance it attaches to defining the boundaries of the treasury management function. This should embrace not only the organisation's treasury management activities, but also the instruments, methods and techniques it may use. There is a wide variety of legal and regulatory frameworks for different public service organisations in this respect.

The matters CIPFA considers it desirable for all organisations to include in the schedules to their treasury management practices are listed in Section 2 of these guidance notes. The following paragraphs explain why CIPFA considers it important that organisations are clear about the treasury management instruments, methods and techniques they may use.

As a general rule, the organisations that comprise the public services are not driven by commercially motivated objectives. That is not to say they are unaware of the need to be efficient in the way they run their services and businesses. It implies that they have influences on their activities which demand that wider issues be taken into account when reaching decisions, notably the need to protect public funds.

The legal and regulatory frameworks governing their activities reflect this in the overriding requirement to control risk. However, many organisations in the public services have the necessary statutory authority to employ treasury management instruments which, if not properly controlled, can expose an organisation to considerable risk.

It is therefore CIPFA's view that organisations need to consider carefully whether they are equipped with the skills and experience to evaluate and control the risks and advantages associated with using the instruments available to them. Only instruments that the organisation has the skills and experience to evaluate should be included in their approved list, even if they are legally permitted to do so.

In certain parts of the public services, regulation prescribes formal processes to determine whether a particular organisation should be allowed access to the full range of instruments available to it. Whether this is or is not a feature of an organisation's regulatory controls, CIPFA believes that an organisation should regularly make an assessment of its treasury management skills and resources.

This is especially true of organisations which have traditionally placed reliance on brokers and other market practitioners to introduce them to, and to help them evaluate and execute, transactions involving novel techniques, the risks of which may not be immediately or wholly apparent.

The consideration of skills and experience is particularly critical where organisations request to be treated as professional clients under MIFID II. Designation under MIFID II should be endorsed by the treasury management strategy and regularly reviewed to ensure that designation remains appropriate.

1.5 ORGANISATION, CLARITY AND SEGREGATION OF RESPONSIBILITIES, AND DEALING ARRANGEMENTS

CIPFA considers that there are certain organisational features that should be commonly applied to the treasury management activities of all public service organisations, regardless of their size, functions and resources. These relate both to the boards/councils responsible for creating and monitoring policy issues and to the officers responsible for managing and executing decisions.

Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures.

As regards officer responsibilities, CIPFA considers it vital that there should be a clear division of responsibilities, including a written statement of the duties of each post engaged in treasury management. It is especially important that staff responsible for negotiating and closing deals are not responsible for recording them, or for maintaining the cash book. Also, staff who are executing the deals should not be responsible for checking compliance with policies and procedures. This is in order to create a framework for internal check, and reflects both the variety of activities in treasury management and the often very large sums involved.

CIPFA recognises that in smaller organisations and those with limited resources, this is more difficult to achieve. Nevertheless, it is a principle to be acknowledged universally, and applied as far as is reasonably practicable.

CIPFA considers clearly defined responsibilities for the approval and scrutiny of treasury management activities to be an essential element of a public service organisation's treasury management arrangements.

The Code recommends the adoption of the following:

This organisation (ie full board/council) will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

This organisation delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to [note 1], and for the execution and administration of treasury management decisions to [note 2], who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

This organisation nominates [note 3] to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Note 1: name of responsible body (for example, committee, board or council) or nominated group of individuals or relevant committee such as cabinet or executive. Where a capital strategy is produced by a local authority this may include the setting of detailed treasury management policies, while being clear that overall responsibility remains with full council.

Note 2: title of responsible officer (for the purposes of this Code, the term 'responsible officer' has been used, although it is recognised that, in practice, many different terms exist). For example in higher education, the vice-chancellor/principal or equivalent is the 'designated officer' who will ensure that the governing body complies with all the terms and conditions of funding provided by the funding body. However it is usual for day-to-day financial management to be delegated to a director of finance who will take professional responsibility for such areas of an institution's work and this is the officer who is referred to here.

Note 3: name of responsible body (for example, committee, board or council) or nominated group of individuals or relevant committee such as audit committee or relevant scrutiny committee.

Source: The Code – Clauses to be Formally Adopted

The following is a list of the main tasks involved in treasury management and a suggested allocation of responsibilities.

(i) Full board/council

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual strategy.

(ii) Boards/committees/council/responsible body

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Body/person(s) with responsibility for scrutiny

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

(iv) The responsible officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.

(v) Treasury manager

- execution of transactions
- adherence to agreed policies and practices on a day-to-day basis
- maintaining relationships with counterparties and external service providers
- supervising treasury management staff
- monitoring performance on a day-to-day basis
- submitting management information reports to the responsible officer
- identifying and recommending opportunities for improved practices.

Where an organisation produces a capital strategy, approved by full board/council, approval of detailed processes may be delegated to a committee or sub-committee of the board/council provided that the capital strategy includes the following as a minimum:

- an overview of the governance process for treasury management including any delegations from full board/council to cabinet/committees etc (note responsibility remains with full board/council)
- a projection of external debt and internal borrowing levels over the long term

- limits on overall borrowing for the following year
- the organisation's risk appetite in terms of treasury management and the key risks it faces in terms of servicing its current and future debt requirement, and how these are managed, along with commentary on the sensitivity of projections
- a summary of the knowledge and skills available to the organisation and confirmation that these are commensurate with the organisation's risk appetite.

In such cases the approval of a separate treasury management strategy is not required by full board/council.

CIPFA believes that delegation of approval of the detail of the treasury management strategy and ongoing monitoring should be permitted where this facilitates more active discussion of the strategy and performance by those with the most appropriate skills and knowledge. Responsibility at all times, however, remains with full board/council who should have access to the full treasury management strategy, annual report and in year monitoring and the ability to seek clarification/ask questions.

The allocation of responsibilities for tasks in (ii) to (iv) above may be influenced by other, wider issues in the way an organisation structures its treasury management function; however, overall responsibility for treasury management at all times remains with the full board/council. Each organisation needs to decide on the arrangements most suited to its particular circumstances for the purpose of achieving these aims, although certain organisations in the public services have particular statutory or regulatory responsibilities placed on their officers and board/committee members.

A further principle which is critical to the effectiveness of a treasury management function is the recognition of the benefits to be gained from centralising the resources devoted to the function, and having an integrated system for overall control. Centralisation and system integration can bring several benefits, including:

- economies of scale
- a single point of control
- coherence of treasury activities
- pooling of expertise
- ease of communications.

1.6 REPORTING REQUIREMENTS AND MANAGEMENT INFORMATION ARRANGEMENTS

A key recommendation of the Code is that an organisation's treasury management policy statement should specify formal reporting arrangements, to include at minimum annual reports both before, mid-year and after the year-end. The monitoring reports for local authorities should include the treasury management indicators detailed in the sector-specific guidance notes.

The details of each organisation's reporting arrangements will be a matter for local decision, but in CIPFA's view, there should at least be a mechanism for reviewing the organisation's policies, and for assessing the effectiveness of the last year's treasury management activities and the performance of the treasury management function.

The reporting arrangements should consider the frequency of reporting, the level of detail reported and also the level within the organisation in which reporting takes place. The reporting arrangements should be a minimum, with additional reporting undertaken as deemed necessary to ensure that those responsible for treasury management are kept fully informed.

The following is a suggested process for reporting to the organisation (ie full board/council or delegated committee or sub-committee) and the body responsible for scrutiny. In many cases, additional reporting on a 'by exception' basis may be appropriate.

Annual reporting requirements before the start of the year

- review of the organisation's approved clauses, treasury management policy statement and practices
- strategy report on proposed treasury management activities for the year.

Mid-year review

- activities undertaken
- variations (if any) from agreed policies/practices
- interim performance report
- regular monitoring
- monitoring of treasury management indicators for local authorities.

Annual reporting requirements after the year-end

- transactions executed and their revenue (current) effects
- report on risk implications of decisions taken and transactions executed
- compliance report on agreed policies/practices, and on statutory/regulatory requirements
- performance report
- report on compliance with CIPFA Code recommendations
- monitoring of treasury management indicators for local authorities.

The detail to be included in these reports will vary depending on an organisation's circumstances. Some organisations may report full details, for example, of transactions undertaken, while others will report only summarised information.

Whatever form the reports take, they should ensure, as a minimum, that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

Regular and meaningful management information on day-to-day activities is also an essential characteristic of an effectively organised treasury management function. The form and frequency of management reports will reflect the scope and nature of an organisation's treasury management activities.

1.7 BUDGETING, ACCOUNTING AND AUDIT ARRANGEMENTS

CIPFA recommends that all public service organisations bring together, for budgeting and management control purposes, all of the costs and revenues associated with an organisation's treasury management activities, regardless of how the organisation has actually organised the treasury management function. This enhances accountability, improves awareness of the resource implications of the function, permits the setting of meaningful performance measures, and increases the effectiveness of value for money and comparative reviews.

Budgeting and accounting for treasury management in the public services differ markedly between the various bodies which comprise it, and are often prescribed by statute or regulation, or are the subject of recognised conventions. As a minimum, however, CIPFA recommends that all organisations' treasury management budgets and accounts should clearly identify:

- staffing numbers and related costs
- premises and other administrative costs
- interest and other investment income
- debt and other financing costs (or charges for the use of assets)
- bank and overdraft charges
- brokerages, commissions and other transaction-related costs
- external advisers' and consultants' charges.

It is normal practice for the external auditor to have access to all papers supporting and explaining the operation and activities of the treasury management function. The auditor will be expected to enquire as to whether the Code has been adopted, and whether its principles and recommendations have been implemented and adhered to. Any serious breach of the Code's recommendations should be brought to the external auditor's attention.

1.8 CASH AND CASH FLOW MANAGEMENT

CIPFA believes that the preparation of cash flow projections on a regular and timely basis provides a sound framework for effective cash management in the public services. Procedures for their preparation and review/modification, the periods to be covered, sources of data, etc should be an integral part of the schedules to an organisation's approved treasury management practices.

There are substantial differences between the various sectors within the public services in the nature and profiles of their cash flows and, therefore, in their cash flow management practices and requirements.

CIPFA recommends that every public service organisation should, as a minimum, prepare cash and cash flow management forecasts and actuals so as to be able to determine:

- whether minimum acceptable levels of cash balances plus short-term investments might be (or have been) breached

- the adequacy (or otherwise) of standby/overdraft facilities or other contingency arrangements
- the optimum arrangements to be made for investing and managing surplus cash
- where capital expenditure and investment is financed initially through internal cash reserves, allowing the requirement for borrowing to be deferred to future years, the impact on future liquidity should be considered.

CIPFA also believes that organisations should put in place proper policies and practices concerning the management of their relationships with their debtors and creditors. As a minimum, CIPFA believes these should include:

- payment scheduling to take account of cash flow and agreed terms of trade
- pricing and charging policies
- monitoring the levels of debtors and creditors to enable corrective action for cash flow purposes
- making effective use of clearing bankers' services, particularly concerning clearance of funds and low-cost funds transmission.

1.9 MONEY LAUNDERING

Money laundering has the objective of concealing the origin of money generated through criminal activity. Legislation has given a higher profile to the need to report suspicions of money laundering. The Proceeds of Crime Act (POCA) 2002 established the main offences relating to money laundering. In summary, these are:

- concealing, disguising, converting, transferring or removing criminal property from England and Wales, from Scotland or from Northern Ireland
- being concerned in an arrangement which a person knows or suspects facilitates the acquisition, retention, use or control of criminal property
- acquiring, using or possessing criminal property.

These apply to all persons in the UK in a personal and professional capacity. Any person involved in any known or suspected money-laundering activity in the UK risks a criminal conviction.

Other offences under the POCA include:

- failure to disclose money-laundering offences
- tipping off a suspect, either directly or indirectly
- doing something that might prejudice an investigation – for example, falsifying a document.

The Terrorism Act 2000 made it an offence of money laundering to become concerned in an arrangement relating to the retention or control of property likely to be used for the purposes of terrorism, or resulting from acts of terrorism. All individuals and businesses in the UK have an obligation to report knowledge, reasonable grounds for belief or suspicion about the proceeds from, or finance likely to be used for, terrorism or its laundering, where it relates to information that comes to them in the course of their business or employment.

Organisations pursuing relevant business were required to appoint a nominated officer and implement internal reporting procedures; train relevant staff in the subject; establish internal procedures with respect to money laundering; obtain, verify and maintain evidence and records of the identity of new clients and transactions undertaken and report their suspicions.

In December 2007 the UK government published the Money Laundering Regulations 2007, which replaced the Money Laundering Regulations 2003.

In order to ensure compliance is appropriately managed, businesses will need to ensure sufficient senior management oversight, appropriate analysis and assessment of the risks of clients and work/product types, systems for monitoring compliance with procedures and methods of communicating procedures and other information to personnel.

Public service organisations and their staff are subject to the full provisions of the Terrorism Act 2000 and may commit most of the principal offences under the POCA, but are not legally obliged to apply the provisions of the Money Laundering Regulations 2007. However, as responsible public bodies, they should employ policies and procedures which reflect the essence of the UK's anti-terrorist financing and anti-money laundering regimes, and it is for individual organisations to evaluate the prospect of laundered monies being handled by them, and to determine the appropriate safeguards to be put in place. It is the legal responsibility of every person engaged in treasury management to make themselves aware of their personal responsibilities, but CIPFA recommends that organisations bring them to their staff's attention and consider the appointment of a member of staff to whom they can report any suspicions.

For more on the application of the UK anti-money laundering regime to public authorities, see the guidance in the 2009 CIPFA publication *Combating Financial Crime*.

1.10 TRAINING AND QUALIFICATIONS

All public service organisations should be aware of the growing complexity of treasury management in general, and its application to the public services in particular. Modern treasury management demands appropriate skills, including a knowledge of money and capital market operations, an awareness of available sources of funds and investment opportunities, an ability to assess and control risk, and an appreciation of the implications of legal and regulatory requirements.

Every public service organisation should secure the necessary training, having assessed the professional competence of both those involved in the treasury management functions and those with a policy, management or supervisory role. Arrangements to ensure the availability of suitable skills and resources should recognise the prospect that staff absences may, at times, demand that others step in who do not normally have involvement on a day-to-day basis with the treasury management function.

Public service organisations have a responsibility to ensure that those charged with governance have access to the skills and knowledge they require to carry out this role effectively. The organisation should ensure that this also applies to treasury management.

Those charged with governance also have a personal responsibility to ensure that they have the appropriate skills and training for their role.

1.11 USE OF EXTERNAL SERVICE PROVIDERS

There are substantial numbers of service providers available to support the treasury management activities of public service organisations. However the skills of the in-house team should be maintained in order to ensure that the services and advice provided can be understood and challenged.

In treasury management, one of the most active and long-standing service providers has been the money-broking companies, whose role it is to act as intermediaries, making introductions between the prospective parties to transactions.

It is not the role of brokers to provide advice on the creditworthiness of those organisations to which public service organisations may lend. They may provide information already in the public domain, but may not interpret it. The use of brokers is a matter for local decision. But it is considered good practice, if their services are used, to ensure that business is spread between a reasonable number of them, and certainly no fewer than two.

Direct dealing with principals is a not uncommon feature of treasury management in the public services which, if nothing else, can provide a useful check on brokers' performance.

An issue that causes some debate is whether it is necessary or desirable for public service organisations to tape conversations with brokers and principals. This is a matter for local discretion, particularly in the context of the costs involved, but is generally to be recommended.

Most public service organisations require the services of clearing bankers, and a growing number make use of the services of a wider group of banks, particularly to meet their need for private finance and partnership funding.

There has also been a growing tendency for public service organisations to employ external advisers and consultants, often for the purposes of a general treasury management advisory service, but also for specific purposes, such as the securing and structuring of funding and for partnership arrangements.

Further, many public service organisations employ the services of external investment managers to help manage their surplus cash and, where relevant, their pension fund, trust fund or endowment fund assets.

Other external providers may include software providers, investment banks and credit rating agencies.

CIPFA advises all organisations using the services of external service providers to document comprehensively the arrangements made with them, to be clear as to the services provided and any indemnities provided and to ensure that these meet the organisation's needs. Services should be subject to regular competition which would usually be via a competitive tendering process.

Organisations should be mindful of the requirements of the Bribery Act 2010 in their dealings with external providers.

The overall responsibility for treasury management must always remain with the organisation.

1.12 CORPORATE GOVERNANCE

The Code recommends that public service organisations state their commitment to embracing the principles of corporate governance in their treasury management activities, notably openness and transparency.

It is CIPFA's view that:

- adoption of the principles and policies promoted in the Code and in these guidance notes will in itself deliver the framework for demonstrating openness and transparency in an organisation's treasury management function
- publication of and free access to information about an organisation's treasury management transactions and other public documents connected with its treasury management activities will further assist in achieving this end
- establishing clear treasury management policies, the separation of roles in treasury management and the proper management of relationships both within and outside the organisation will establish the integrity of the function
- robust treasury management organisational structures, together with well-defined treasury management responsibilities and job specifications, will enhance accountability
- equality in treasury management dealings, absence of business favouritism and the creation of keen competition in treasury management will lay the groundwork for fairness.

The following paragraphs further emphasise the practices that CIPFA believes an organisation should employ to ensure the principles of corporate governance are successfully implemented.

Procedural responses

The policies and strategies of treasury management should link clearly to the organisation's other key policies and strategies. In the management of risk, in particular, treasury risk management should be an integral part of its overall risk management processes, culminating in a well-defined, organisation-wide strategy for the control of risk and contingency planning.

The management and administration of treasury management should be robust, rigorous and disciplined. Over the years, some of the most significant examples of treasury mismanagement, in both the public services and the private sector, have resulted from procedural indiscipline. This has frequently been as a result of a failure to apply otherwise well-documented management and administration systems, or through failures in transmission, documentation or deal-recording processes.

Reporting arrangements should be applied so as to ensure that those charged with responsibility for the treasury management policy have all the information necessary to enable them to fulfil openly their obligations; and that all stakeholders are fully appraised of and consulted on the organisation's treasury management activities on a regular basis.

The procedures for monitoring treasury management activities through audit, scrutiny and inspection should be sound and rigorously applied, with an openness of access to information and well-defined arrangements for the review and implementation of recommendations for change.

The application and interpretation of performance data should be clear, concise and relevant to the organisation's treasury management activities.

Stewardship responsibilities

The responsible officer should ensure that systems exist to deliver proper financial administration and control, and a framework for overseeing and reviewing the treasury management function.

As regards a control framework, an organisation's formal policy documents should define clearly procedures for monitoring, control and internal check.

With regard to delegation, it is vitally important that those involved in the implementation of treasury management policies and the execution of transactions are unambiguously empowered to undertake their tasks, and that reporting lines are well defined.

An organisation's adoption of and adherence to the Code should be widely broadcast, as should the principles of the Code and the method of its application in the organisation.

The organisation's procedures for reviewing the value of the treasury management function, and the implementation of opportunities for improvement, should be both continuous and open to examination.

The governance of others

In respect of the organisation's dealings with counterparties, external service providers and other interested parties, clear procedures should exist to enable the organisation, as far as is practicable, to monitor their adherence to the legal or regulatory regimes under which they operate.

Where external funds are managed on behalf of a third party or pension fund, these funds should be separately identifiable and income and expenditure attributed in line with an agreed policy.

Suggested schedules to accompany an organisation's statement of its treasury management practices

The following paragraphs give suggestions to public service organisations on the schedules they might prepare and maintain in support of their approved treasury management and investment practices. CIPFA suggests that these schedules be maintained and updated as necessary, and that they form an integral part of an organisation's treasury management manual.

Additionally, where documentation or contracts exist, for example as evidence of relationships with external service providers, CIPFA suggests that their existence should be referred to in the schedules, and that a full copy, or at minimum a brief summary, of their terms, conditions, maturity dates and renewal arrangements should be appended.

CIPFA recognises that not all these schedules will be relevant or appropriate to every organisation covered by the Code and these guidance notes.

RISK MANAGEMENT

Credit

- criteria to be used for creating/managing approved counterparty lists/limits
- approved methodology for changing limits and adding/removing counterparties
- full individual listings of counterparties and counterparty limits
- country, sector and group listings of counterparties and the overall limits applied to each, where appropriate
- details of credit rating agencies' services and their application
- description of the general approach to collecting and using information other than credit ratings for counterparty risk assessment.

Liquidity

- amounts of approved minimum cash balances and short-term investments
- details of:
  - standby facilities
  - bank overdraft arrangements
  - short-term borrowing facilities
  - insurance/guarantee facilities
  - other contingency arrangements
- policy in terms of borrowing in advance of need.

Interest rate

- details of approved interest rate exposure limits
- trigger points and other guidelines for managing changes to interest rate levels
- minimum/maximum proportions of variable rate debt/interest
- minimum/maximum proportions of fixed rate debt/interest
- policies concerning the use of financial derivatives for interest rate risk management.

Exchange rate

- details of approved exchange rate exposure limits for cash investments/debt
- approved criteria for managing changes in exchange rate levels
- policies concerning the use of financial derivatives for exchange rate risk management.

Refinancing

- debt/other capital financing maturity profiling, policies and practices
- projected capital investment requirements
- policy concerning limits on revenue consequences of capital financings.

Legal and regulatory

- references to relevant statutes and regulations
- procedures for evidencing the organisation's powers/authorities to counterparties
- required information from counterparties concerning their powers/authorities
- statement on the organisation's political risks and management of same.

Fraud, error and corruption, and contingency management

- details of systems and procedures to be followed, including internet services
- emergency and contingency planning arrangements
- insurance cover details.

Market value of investments

- details of approved procedures and limits for controlling exposure to investments whose capital value may fluctuate.

PERFORMANCE MEASUREMENT

- methodology to be applied for evaluating the impact of treasury management decisions
- policy concerning methods for testing value for money in treasury management, eg:
  - frequency and processes for tendering
  - banking services
  - money-broking services
  - cash/fund management services
  - consultants'/advisers' services
  - other providers' services
- methods to be employed for measuring the performance of the organisation's treasury management activities
- benchmarks and calculation methodology with regard to risk and return:
  - debt management
  - investment.

DECISION MAKING AND ANALYSIS

- funding, borrowing, lending, and new instruments/techniques:
  - records to be kept
  - processes to be pursued
  - issues to be addressed.

APPROVED INSTRUMENTS, METHODS AND TECHNIQUES

- listings and individual limits for the use of:
  - approved instruments
  - approved methods
  - approved techniques
  - approved investments.

ORGANISATION, CLARITY AND SEGREGATION OF RESPONSIBILITIES, AND DEALING ARRANGEMENTS

- limits to responsibilities/discretion at committee/executive levels
- principles and practices concerning segregation of duties
- treasury management organisation chart
- statement of duties/responsibilities of each treasury/relevant post
- absence cover arrangements
- dealing/approval limits
- list of approved brokers
- policy on brokers' services

- policy on taping of conversations
- direct dealing practices
- settlement transmission procedures
- documentation requirements
- arrangements concerning the management of counterparty funds.

REPORTING REQUIREMENTS AND MANAGEMENT INFORMATION ARRANGEMENTS

- content and frequency of board/committee reporting requirements
- content and frequency of management information reports.

BUDGETING, ACCOUNTING AND AUDIT ARRANGEMENTS

- statutory/regulatory requirements
- accounting practices and standards
- list of information requirements of external auditors.

CASH AND CASH FLOW MANAGEMENT

- arrangements for preparing/submitting cash flow statements
- content and frequency of cash flow budgets
- listing of sources of information
- bank statements procedures
- payment scheduling and agreed terms of trade with creditors
- arrangements for monitoring debtor/creditor levels
- procedures for banking of funds
- practices concerning prepayments to obtain benefits.

MONEY LAUNDERING

- procedures for establishing identity/authenticity of lenders
- methodology for identifying sources of deposit.

TRAINING AND QUALIFICATIONS

- details of approved training courses
- details of approved qualifications
- details of qualifications of treasury and other relevant staff
- records of training received by treasury and other relevant staff
- records of training received by those charged with governance.

USE OF EXTERNAL SERVICE PROVIDERS

- details of contracts with service providers, including bankers, brokers, consultants, advisers and details of the services provided
- regulatory status of services provided
- procedures and frequency for tendering services.

CORPORATE GOVERNANCE

- list of documents to be made available for public inspection
- procedures for consultation with stakeholders
- list of external funds managed on behalf of others and the basis of attributing interest earned and costs to these investments.

SECTION 3

Guidance on investments that are not part of treasury management activity

For any investments the organisation makes the organisation should understand the powers under which the investment is made, the extent to which the capital invested is placed at risk and the impact of any potential losses on the financial sustainability of the organisation. This should be reviewed on a regular basis to take account of changes in market and other conditions.

This section provides advice for organisations that invest in other financial assets and property primarily for financial return that are not part of treasury management activity. 'Treasury management investments' activity covers those investments which arise from the organisation's cash flows and debt management activity, and ultimately represent balances which need to be invested until the cash is required for use in the course of business.

It is recognised that organisations may make investments for policy reasons outside of normal treasury management activity. This may include:

- 'service investments' held clearly and explicitly in the course of the provision, and for the purposes, of operational services, including regeneration
- 'commercial investments' which are taken for mainly financial reasons. These may include investments arising as part of business structures, such as shares and loans in subsidiaries or other outsourcing structures such as IT providers or building services providers; or investments explicitly taken with the aim of making a financial surplus for the organisation. Commercial investments also include non-financial assets which are held primarily for financial benefit, such as investment properties.

Commercial investments for financial benefit rather than for service outcomes are sometimes entered into outside of normal treasury management activity. These need more careful financial risk assessment. Where such investments do not give priority for security and liquidity over yield, whether because of the nature of the assets themselves or for valid service reasons, CIPFA recommends that such a decision should be explicit, the additional risks set out clearly and the impact on financial sustainability identified and reported.

It is critical that due diligence processes and procedures reflect the additional risk an organisation is taking on. Due diligence procedures should ensure effective scrutiny of proposed investments, identification of risk to both capital and returns, any external underwriting of those risks, and the potential impact on the financial sustainability of the organisation if those risks come to pass. Where necessary independent and expert advice should be sought to ensure due diligence is suitably robust.

It is expected that many of the principles underlying TMPs 1 to 12 will apply to non-treasury investments as they do to treasury investments. However, some aspects including governance and management are likely to be significantly different. A published schedule should be agreed by full board/council that sets out the organisation's investment management practices for non-treasury investments. This should be complied with by all officers or agencies responsible for such investments. Where a capital strategy is produced by a local authority including the authority's approach to commercial activities, the detail may be published separately and delegated to a relevant committee or group of individuals such as the cabinet or executive while remaining clear that overall responsibility remains with full council. The authority should ensure effective arrangements are in place for the effective scrutiny of strategy and policies.

A register of investments and financial guarantees should be maintained and regularly reviewed as part of performance reporting arrangements, including periodic reassessment of the probability of financial guarantees being called upon. This register should be reconciled to the financial instruments disclosures within the statement of accounts.

SUGGESTED SCHEDULES TO ACCOMPANY AN ORGANISATION'S STATEMENT OF ITS PRACTICES IN RELATION TO NON-TREASURY MANAGEMENT INVESTMENTS

The cross-references to TMPs in brackets below indicate where the equivalent issue is dealt with in TMPs.

- risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios
- performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments
- decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments, and arrangements to ensure that appropriate professional due diligence is carried out to support decision making
- reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken
- training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

CIPFA The Chartered Institute of Public Finance & Accountancy

Essential Reference Paper "D"

the prudential code

for Capital Finance in Local Authorities

2017 Edition

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed. As the world's only professional accountancy body to specialise in public services, CIPFA's qualifications are the foundation for a career in public finance. We also champion high performance in public services, translating our experience and insight into clear advice and practical services. Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance.

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Published by:

CIPFA \ THE CHARTERED INSTITUTE OF PUBLIC FINANCE AND ACCOUNTANCY

77 Mansell Street, London E1 8AN

020 7543 5600 \ customerservices@cipfa.org \ www.cipfa.org

ISBN 978 1 84508 496 7

Designed and typeset by Ministry of Design, Bath
(www.ministryofdesign.co.uk)

Foreword

The CIPFA *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) underpins the system of capital finance. This new edition makes important changes that reflect developments since the Prudential Code was last updated in 2011.

Local authorities determine their own programmes for capital investment in non-current assets that are central to the delivery of quality local public services. The Prudential Code has been developed as a professional code of practice to support them in taking these decisions. Authorities are required by regulation to have regard to the Prudential Code when carrying out their duties in England and Wales under Part 1 of the Local Government Act 2003, in Scotland under Part 7 of the Local Government in Scotland Act 2003 and in Northern Ireland under Part 1 of the Local Government Finance Act (Northern Ireland) 2011.

The Prudential Code is set out in this document and comprises the paragraphs in bold type. The explanatory statements are in standard type and shall be regarded as part of the Prudential Code insofar as they assist in interpreting the Prudential Code.

The *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes* (CIPFA, 2017) sets out good practice in treasury management and is complementary to this Code.

Contents

SECTION ONE

Executive summary

INTRODUCTION

E1 The Prudential Code plays a key role in capital finance in local authorities. Local authorities determine their own programmes for capital investment that are central to the delivery of quality public services. The Prudential Code was developed by CIPFA, the Chartered Institute of Public Finance and Accountancy, as a professional code of practice to support local authorities in taking their decisions. Local authorities are required by regulation to have regard to the Prudential Code when carrying out their duties in England and Wales under Part 1 of the Local Government Act 2003, in Scotland under Part 7 of the Local Government in Scotland Act 2003 and in Northern Ireland under Part 1 of the Local Government Finance Act (Northern Ireland) 2011.

E2 In financing capital expenditure, local authorities are governed by legislative frameworks including the requirement to have regard to CIPFA's *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes*, the latest version of which represents good practice in this area.

OBJECTIVES

E3 The framework established by the Prudential Code should support local strategic planning, local asset management planning and proper option appraisal. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital expenditure plans of local authorities are affordable, prudent and sustainable, and that 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. In exceptional cases the Prudential Code should provide a framework which will demonstrate that there is a danger of not ensuring this, so that the local authority concerned can take timely remedial action.

E4 The Prudential Code requires authorities to look at capital expenditure and investment plans in the light of overall organisational strategy and resources and ensure that decisions are being made with sufficient regard to the long run financing implications and potential risks to the authority. Effective financial planning, option appraisal, risk management and governance processes are essential in achieving a prudential approach to capital expenditure, investment and debt.

E5 To demonstrate that local authorities have fulfilled these objectives, the Prudential Code sets out the indicators that must be used, and the factors that must be taken into account. The Prudential Code does not include suggested indicative limits or ratios. These will be for the local authority to set itself, subject only to any controls under Section 4 of the Local Government Act

2003 (England and Wales), Section 36 of the Local Government in Scotland Act 2003 (Scotland) and Section 14 of the Local Government Finance Act (Northern Ireland) 2011.

E6 The prudential indicators required by the Prudential Code are designed to support and record local decision-making in a manner that is publicly accountable. They are not designed to be comparative performance indicators. They should be considered in parallel with the treasury management indicators required by the CIPFA *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes*.

SCOPE

E7 The Prudential Code applies to all local authorities, including combined authorities, police, fire and other authorities.

PROCESS AND GOVERNANCE ISSUES

E8 The Prudential Code sets out a clear governance procedure for the setting and revising of a capital strategy and prudential indicators. This will be done by the same body that takes the decisions for the local authority's budget – ie usually it will be the full council for the authority concerned. The chief finance officer will be responsible for ensuring that all matters required to be taken into account are reported to the decision-making body for consideration, and for establishing procedures to monitor performance. Where budget decisions are made by an elected mayor or a police and crime commissioner, it is expected that the capital strategy and prudential indicators will follow the same procedures as the budget.

E9 Prudential indicators for previous years will be taken directly from information in local authorities' Statements of Accounts. If any item within a local authority's Statement of Accounts that is relied on for a prudential indicator is the subject of audit qualification, this must be highlighted when the prudential indicators are set or revised.

MATTERS REQUIRED TO BE TAKEN INTO ACCOUNT

E10 In setting or revising its prudential indicators, the local authority is required to have regard to the following matters:

- service objectives, eg strategic planning for the authority
- stewardship of assets, eg asset management planning
- value for money, eg option appraisal
- prudence and sustainability, eg risk, implications for external debt and whole life costing
- affordability, eg implications for council tax/district rates
- practicality, eg achievability of the forward plan.

E11 The Local Government Act 2003 and the Local Government Finance Act (Northern Ireland) 2011 refer to affordability and the requirement that local authorities in England, Wales and Northern Ireland determine and keep under review the amount of money they can afford to borrow for capital investment. The Local Government in Scotland Act 2003 requires Scottish local authorities to keep under review the maximum amount they can afford to allocate to capital expenditure. In order to carry out their duties under legislation in respect of affordability, local authorities are required to have regard to all those aspects of the Prudential Code that relate to affordability, sustainability and prudence.

DECISION-MAKING ON CAPITAL INVESTMENT

E12 A soundly formulated capital investment programme must be driven by the desire to provide high quality, value for money public services. The Prudential Code recognises that in making its capital investment decisions the authority must have explicit regard to option appraisal and risk, asset management planning, strategic planning for the authority and achievability of the forward plan.

DETERMINING A CAPITAL STRATEGY

E13 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, authorities should have in place a capital strategy that sets out the long-term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

PRUDENCE

E14 **The local authority shall ensure that all of its capital and investment plans and borrowing are prudent and sustainable. In doing so it will take into account its arrangements for the repayment of debt (including through MRP/repayment of loans fund) and consideration of risk and the impact, and potential impact, on the authority's overall fiscal sustainability. While indicators for sustainability are required to be set over a minimum three year rolling period, indicators should be set in line with a capital strategy and asset management plan that is sustainable over the longer term. Where statutorily ringfenced resources such as the HRA or Police Fund exist, the indicators should be set separately for these areas.**

E15 Both the authorised limit and the operational boundary for external debt need to be consistent with the authority's plans for capital expenditure and financing, and with its treasury management policy statement and practices. Risk analysis and risk management strategies should also be taken into account. The operational boundary should be based on the authority's estimate of most likely, ie prudent, but not worst case scenario and should equate to the maximum level of external debt projected by this estimate. The authorised limit in addition needs to provide headroom over and above the operational boundary, sufficient for example for unusual cash movements.

E16 In order to ensure that over the medium term net debt will only be for a capital purpose, the local authority should ensure that gross external debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. Authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. Authorities should also consider carefully whether they can demonstrate value for money in borrowing in advance of need and can ensure the security of such funds.

E17 Local authorities are reminded that the prime policy objective of their treasury management investment activities is the security of funds, and they should avoid exposing public funds to inappropriate or unquantified risk. Authorities should consider a balance between security, liquidity and yield which reflects their own risk appetite but which prioritises security and liquidity over yield. It is therefore important that authorities adopt an appropriate approach to risk management with regard to their treasury management activities that is proportionate to the overall level of resources available to the organisation.

AFFORDABILITY

E18 The fundamental objective in the consideration of the affordability of the authority's capital plans is to ensure that the total capital investment of the authority remains within sustainable limits. In considering the affordability of its capital plans, the authority is required to consider all of 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.

E19 Consideration of affordability should be considered in the light of the authority's medium-term forecast and other fiscal strategies. Capital expenditure plans should be considered alongside the cost of past borrowing, maintenance requirements and planned disposals. The authority's MRP/loans fund policy will have a critical impact on the overall affordability of new borrowing and for this reason it is important to look at affordability not just in the medium term but also over the life of the asset base or underlying debt.

E20 Where ringfenced resources or separate funds such as the HRA or Police Fund exist, affordability must be considered against those resources available to fund borrowing. Under combined authority arrangements affordability may need to be considered against combined authority resources and the impact on underlying authorities. Where debt or guarantees relating to local enterprise partnerships (LEPs), subsidiaries or other corporate and non-corporate bodies exist, the impact on the authority should be considered. In these cases the development of local indicators may be appropriate.

E21 When considering affordability, the authority needs to pay due regard to risk and uncertainty. Risk analysis and risk management strategies should be taken into account.

CONCLUSION

E22 The Prudential Code supports the system of capital investment in local authorities. It is integrated within the wider statutory and management processes of local government. Key elements of the system continue to be determined through legislation, in particular the amount required to be charged to taxation by local authorities in respect of capital investment and the amount and method of government support for capital investment. These will be significant considerations when local government takes decisions on capital investment. However, the level of capital investment that can be supported will, subject to affordability and sustainability, be a matter for local decision.

SECTION TWO

Objectives

1 **The framework established by the Prudential Code should support:**

(a) local strategic planning

(b) local asset management planning

(c) proper option appraisal.

The objectives of the Prudential Code are to provide a framework for local authority capital finance that will ensure for individual local authorities that:

(d) capital expenditure and investment plans are affordable

(e) all external borrowing and other long-term liabilities are within prudent and sustainable levels

(f) treasury management and other investment decisions are taken in accordance with professional good practice

and that in taking decisions in relation to (d) to (f) above the local authority is:

(g) accountable, by providing a clear and transparent framework.

In exceptional circumstances the objective of the Prudential Code is to provide a framework that will demonstrate that there is a danger of not ensuring the above, so that the authority can take timely remedial action.

2 A framework for the internal control and self-management of capital finance needs to deal with all three of the following elements:

- capital expenditure and investment plans
- external debt
- treasury management.

3 The Prudential Code requires authorities to look at capital expenditure and investment plans in the light of overall organisational strategy and resources and ensure that decisions are being made with sufficient regard to the long run financing implications and potential risks to the authority. Effective financial planning, option appraisal and governance processes are essential in achieving a prudential approach to capital expenditure, investment and debt.

4 The framework in this Prudential Code includes a set of prudential indicators. These need to be taken together, integrated into a coherent entity, rather than individually. The setting of the forward-looking prudential indicators will in practice need to be a circular rather than a linear process. For example, forward estimates for external debt will follow on from the authority's capital plans, revenue forecasts and treasury management strategy. However, if initial estimates would result in outcomes that would not be affordable or prudent, then forward plans for capital and/or revenue will need to be reconsidered before they are finalised. The Prudential Code supports a framework of good financial management, thus facilitating

the avoidance of situations where urgent remedial action may be needed. At all times, the objectives specified in paragraph 1 of this Prudential Code are paramount to the operation of the prudential framework.

5 The prudential indicators are designed to support and record local decision making. They are not designed to be comparative performance indicators and the use of them in this way would be likely to be misleading and counter-productive. In particular, local authorities had widely different debt positions on the introduction of the Prudential Code and the differences are likely to increase over time as a result of the exercise of local choices. The system is specifically designed to support such local decision making in a manner that is publicly accountable.

6 Prudential indicators that are limits are for the determination of the local authority subject only to any long-stop controls under Section 4 of the Local Government Act 2003 (England and Wales), Section 36 of the Local Government in Scotland Act 2003 (Scotland) and Section 14 of the Local Government Finance Act (Northern Ireland) 2011.

7 Any upper limit imposed centrally under legislation will run parallel to any locally determined limit, in which case the lower of the imposed limit and the locally determined limit will be the effective limit.

8 The prudential indicators specified in the Prudential Code are the minimum required. Local authorities may set further prudential indicators if they wish, and are encouraged to do so where this would assist their own management processes. However, any additional prudential indicators set locally should not, unless required to do so by legislation or official guidance, associate any part of the authority's external borrowing with particular item(s), category(ies) or purpose(s) of expenditure other than where it relates to a specific funding source or a subsidiary, associate or joint venture. The authority should have an integrated treasury management strategy within which its borrowing and investments are managed.

9 This Prudential Code focuses on capital finance and effective capital planning. The CIPFA *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes* focuses on effective treasury management and also requires a number of treasury management indicators which are complementary to this Prudential Code and the two should be referred to in parallel.

SECTION THREE

Scope

10 The Prudential Code applies to all local authorities, including police, fire, combined and other authorities which:

- in England and Wales are defined in legislation for the purposes of Part 1 of the Local Government Act 2003
- in Scotland are defined in legislation for the purposes of Part 7 of the Local Government in Scotland Act 2003, and
- in Northern Ireland are defined in legislation for the purposes of Part 1 of the Local Government Finance Act (Northern Ireland) 2011.

11 The Prudential Code covers all capital expenditure and investment decisions and should take account of all potential long-term liabilities relevant to the authority. For authorities that are required to prepare group accounts or those involved in combined authority arrangements, the consideration of investments and liabilities should include all those in which a residual interest remains with the authority.

Matters required to be taken into account when setting up or revising prudential indicators

12 **In setting or revising its prudential indicators, the local authority is required to have regard to the following matters:**

- **service objectives, eg strategic planning for the authority**
- **stewardship of assets, eg asset management planning**
- **value for money, eg option appraisal**
- **prudence and sustainability, eg risks, whole life costing and implications for external debt**
- **affordability, eg implications for long-term resources and ultimately the council tax**
- **practicality, eg achievability of the forward plan.**

13 The Local Government Act 2003, the Local Government in Scotland Act 2003 and the Local Government Finance Act (Northern Ireland) 2011 refer to affordability and the requirement that authorities determine and keep under review the amount of money they can afford to borrow for capital investment (in England, Wales and Northern Ireland) and (in Scotland) the maximum amount they can afford to allocate to capital expenditure. For England, Wales and Northern Ireland, the legislation requires authorities to consider credit arrangements in this calculation and for Scotland, the affordability calculation encompasses both the borrowing of money and other long-term liabilities arising from capital investment. The Prudential Code refers to both affordability and prudence. The two are related concepts. In order to ensure long-term affordability, decisions have also to be prudent and in the long term sustainable. Therefore, in carrying out their duties under legislation in respect of affordability, local authorities are required to have regard to all those aspects of the Prudential Code that relate to affordability, sustainability and prudence including risk. The Prudential Code also requires local authorities to have regard to wider management processes (option appraisal, asset management planning, strategic planning and achievability) in accordance with good professional practice.

14 The prudential indicators provide a broad framework to be considered alongside robust forecasting procedures embedded into the budget consideration process of the local

authority. Forecasts should be regularly updated as the capital programme develops, and proposals should be considered in terms of their impact on the overall corporate position. Integration of these features into financial processes ensures that prudence and affordability are taken into account.

Process and governance issues

GOVERNANCE

15 **Decisions around capital expenditure, investment and borrowing should align with the processes established for the setting and revising of the budget for the local authority.**

16 The body that sets the budget for the local authority will usually be the full council of that local authority. Whether or not this is the case, the responsibility for decision-making and ongoing monitoring in respect of capital expenditure, investment and borrowing, including prudential indicators, remains with full council. Although detailed implementation and monitoring may be delegated to a committee, ultimate responsibility lies with full council. In assessing how full council's responsibility is best delivered, authorities may wish to consider where the skills and knowledge to effectively implement and monitor detailed arrangements are placed within governance structures and how the active engagement of full council is best achieved.

17 Where budget decisions are made by an elected mayor or a police and crime commissioner, it is expected that the capital strategy and prudential indicators will follow the same procedures as the budget.

18 Local authorities may determine the capital strategy, capital programme and prudential indicators ahead of the revenue budget. The requirements of the Prudential Code are met provided that explicit reference to the formal decision is made within the revenue budget report.

DETERMINING A CAPITAL STRATEGY

19 **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, authorities should have in place a capital strategy that sets out the long-term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes. The capital strategy should form a part of the authority's integrated revenue, capital and balance sheet planning.**

20 As local authorities become increasingly complex and diverse it is vital that those charged with governance understand the long-term context in which investment decisions are made and all the financial risks to which the authority is exposed. With local authorities

having increasingly wide powers around commercialisation, more being subject to group arrangements and the increase in combined authority arrangements it is no longer sufficient to consider only the individual local authority but also the residual risks and liabilities to which it is subject.

21 **The capital strategy is intended to give a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability.** The development of a capital strategy allows flexibility to engage with full council to ensure that the overall strategy, governance procedures and risk appetite are fully understood by all elected members.

22 **The capital strategy should be tailored to the authority's individual circumstances but should include capital expenditure, investments and liabilities and treasury management. The capital strategy should include sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured and to meet legislative requirements on reporting.**

23 In considering how stewardship, value for money, prudence, sustainability and affordability can be demonstrated local authorities should have regard to the following key areas where material.

Capital expenditure

- An overview of the governance process for approval and monitoring of capital expenditure, including links to the authority's policies on capitalisation.
- A long-term view of capital expenditure plans, where long term is defined by the financing strategy of and risks faced by the authority with reference to the life of projects/assets.
- An overview of asset management planning including the cost of past borrowing, maintenance requirements and planned disposals.
- Any restrictions around borrowing or funding of ongoing capital finance, for example requirements around the HRA or Police Funds.

Debt and borrowing and treasury management

- A projection of external debt and use of internal borrowing[1] to support capital expenditure (authorities are encouraged to compare this with the capital financing requirement and establish an appropriate liability benchmark[2]).
- Provision for the repayment of debt over the life of the underlying debt.
- Authorised limit and operational boundary for the following year (see below).
- The authority's approach to treasury management including processes, due diligence and defining the authority's risk appetite.

1. Internal borrowing refers to the use of internal cash balances to finance capital expenditure in place of borrowing money from external sources.
2. As proposed in the *Treasury Risk Management Toolkit for Local Authorities* (CIPFA, 2012).

Commercial activity

- The authority's approach to commercial activities including processes ensuring effective due diligence and defining the authority's risk appetite in respect of these, including proportionality in respect of overall resources. Requirements for independent and expert advice and scrutiny arrangements. While business cases may provide some of this material, these will often reflect historic rather than current circumstances so the information contained in them will need to be periodically re-evaluated when it will inform the authority's overall strategy.

Other long-term liabilities

- An overview of the governance process for approval and monitoring and ongoing risk management of any other financial guarantees and other long-term liabilities.

Knowledge and skills

- A summary of the knowledge and skills available to the authority and confirmation that these are commensurate with the authority's risk appetite.

24 In developing the capital strategy a balance should be struck between the amount of detail included and accessibility to the key audience. Where detailed information is required thought should be given to how this is made available, its format and the training needs of members to encourage active engagement. The role of the formal scrutiny process should not be overlooked in ensuring effective challenge. Links should be made where appropriate to the treasury management strategy. The chief finance officer should report explicitly on the affordability and risk associated with the capital strategy and where appropriate have access to specialised advice to enable them to reach their conclusions.

SETTING AND REVISING PRUDENTIAL INDICATORS

25 **Prudential indicators, other than actuals that are taken from information in the local authority's Statement of Accounts, are required to be set and where they are revised, revised alongside the processes established for the setting and revising of the budget for the local authority. These prudential indicators must be set and where they are revised, revised in accordance with the matters required to be taken into account (paragraphs 12–14).**

26 The body that sets the budget for the local authority (the decision-making body) will usually be the full council of that local authority. Whether or not this is the case, the setting of the capital expenditure estimates, operational boundary and authorised limit should follow the same route as the setting and revising of the budget of the local authority. Other indicators may be delegated to committees or subcommittees of full council although full council retains overall responsibility. Where other indicators are delegated the impact of these should be taken into account when setting the capital expenditure estimates, operational boundary and authorised limit.

27 **The prudential indicators for the forthcoming and following years must be set before the beginning of the forthcoming year. They may be revised at any time, following due process, and must be reviewed, and revised if appropriate, for the current year when the prudential indicators are set for the following year.**

28 Provided that the total authorised limit and the total operational boundary[3] for external debt for a year are unchanged, movement may be made between the separately identified figures within these prudential indicators for borrowing and other long-term liabilities by the chief finance officer. Any such changes should be reported to the next meeting of the body that sets the budget for the local authority.

29 In order to be able to respond to unforeseen and extraordinary circumstances, the prudential indicator for the authorised limit for the time being in force shall be treated as increased where Section 5 of the Local Government Act 2003 (England and Wales) applies:

(1) Subject to subsection (2), any limit for the time being determined by or for a local authority under section 3, or applicable to it under section 4, shall be treated for the purposes of this Chapter as increased by the amount of any payment which–

(a) is due to the authority in the period to which the limit relates, but

(b) has not yet been received by it.

(2) In the case of a limit determined under section 3, or set under section 4(2), subsection (1) shall not apply to any payment whose delayed receipt was taken into account in arriving at the limit.

30 In Northern Ireland, the prudential indicator for the authorised limit for the time being in force shall be treated as increased where Section 15 of the Local Government Finance Act (Northern Ireland) 2011 applies:

(1) Subject to subsection (2), any limit for the time being determined by or for a local authority under section 13, or applicable to it under section 14, shall be treated for the purposes of this Chapter as increased by the amount of any payment which–

(a) is due to the authority in the period to which the limit relates, but

(b) has not yet been received by it.

(2) In the case of a limit determined under section 13, or set under section 14(2), subsection (1) shall not apply to any payment whose delayed receipt was taken into account in arriving at the limit.

31 Any reliance on Section 5 (or Section 15 in Northern Ireland) to borrow above the authorised limit should be reported to the next meeting of the body that sets the budget for the local authority.

32 **Prudential indicators for external debt for previous years are to be taken directly from information in the local authority's Statement of Accounts.**

33 If an item in the authority's Statement of Accounts that is relied on for a prudential indicator is the subject of audit qualification, this must be highlighted when prudential indicators are set, reviewed and/or revised.

34 Prudential indicators for financing costs and their impact on the budget, external debt and capital expenditure should not be set or revised in isolation from one another, but considered together and in conjunction with the authority's strategic service and asset management

3 See paragraphs 55–56 for an explanation of these terms.

planning processes. It would be logical for these to be considered when the budget for the local authority is set.

35 The chief finance officer is responsible for ensuring that matters required to be taken into account when setting or revising prudential indicators (paragraphs 12–14) are reported to the decision-making body for consideration.

36 It should be noted that:

- in England and Wales, the prudential indicator for the authorised limit for external debt for the current year is the statutory limit determined under Section 3(1) of the Local Government Act 2003: "*A local authority shall determine and keep under review how much money it can afford to borrow*"
- in Scotland, the prudential indicator for the estimate of capital expenditure for the current year is the statutory limit determined under Section 35(1) of the Local Government in Scotland Act 2003: "*It is the duty of a local authority to determine and keep under review the maximum amount which it can afford to allocate to capital expenditure*"
- in Northern Ireland, the prudential indicator for the authorised limit for external debt for the current year is the statutory limit determined under Section 13(1) of the Local Government Finance Act (Northern Ireland) 2011: *"A council shall determine and keep under review how much money it can afford to borrow"*.

37 This section of the Prudential Code establishes a clear governance procedure for the setting and revising of prudential indicators. This assists transparency and ensures accountability.

38 **Local indicators**

Authorities should consider whether additional local indicators are needed to reflect local circumstances, including local indicators showing the impact of residual liabilities arising from group structures where relevant. Where appropriate, to improve understanding and relevance, these may be substituted for the relevant indicator set out within this code with the exception of the authorised limit and operational boundary.

MONITORING AGAINST PRUDENTIAL INDICATORS

39 **The chief finance officer is required to establish procedures to monitor performance against all forward-looking indicators. The chief finance officer will need to establish a measurement and reporting process that highlights significant deviations from expectations.**

40 The chief finance officer should have particular regard to the following with respect to prudential indicators and external debt:

- In respect of the prudential indicators for the authorised limit for external debt, where the chief finance officer forms the view that a limit is likely to be breached[4] a report to the decision-making body is required. It will then be for the decision-making body to determine if it would be prudent to raise the current limit or, alternatively, to instigate

4. Other than where Section 5 of the Local Government Act 2003 applies.

procedures to ensure that the current limit is not breached. It would be good practice for the chief finance officer to establish an appropriate early warning system.

- In respect of the prudential indicators for the operational boundary for external debt and estimate of the ratio of financing costs to net revenue stream, these are estimates. It will probably not be significant if the operational boundary is breached temporarily on occasions due to variations in cash flow. However, a sustained or regular trend above the operational boundary would be significant and should lead to further investigation and action as appropriate.
- Regular monitoring should be undertaken in-year against key measures of affordability and sustainability, by reviewing estimates of financing costs to revenue and the capital financing requirement. Significant variation in the estimates used to calculate these prudential indicators, for example caused by major overruns of expenditure on other projects or by not achieving projected in-year capital receipts, should trigger management action. This will be particularly important before entering irrevocably into major commitments.

41 In respect of prudential indicators and capital expenditure, it should be recognised that it is in the nature of capital expenditure to have variations from short-term time estimates and it is the success of the overall rolling medium-term plan that is important. However, regular monitoring will assist the management of the authority's capital plans.

42 The chief finance officer should make arrangements for monitoring with respect to gross debt and the capital financing requirement such that any deviation from the requirement in paragraph 62 is reported to him or her, since any such deviation may be significant and should lead to further investigation and action as appropriate.

SECTION SIX

Prudence and prudential indicators for prudence

43 **The local authority shall ensure that all of its capital expenditure, investments and borrowing decisions are prudent and sustainable. In doing so it will take into account its arrangements for the repayment of debt (including through MRP/loans fund repayments) and consideration of risk and the impact, and potential impact, on the authority's overall fiscal sustainability. While indicators for sustainability are required to be set over a minimum three year rolling period, indicators should be set in line with a capital strategy and asset management plan that is sustainable over the longer term. Where statutorily ringfenced resources such as the HRA or Police Fund exist, the indicators of prudence should be set separately for these areas.**

44 Local authorities are reminded that the prime policy objective of their treasury management investment activities is the security of funds, and they should avoid exposing public funds to unnecessary or unquantified risk. Authorities should consider a balance between security, liquidity and yield which reflects their own risk appetite but which prioritises security and liquidity over yield. It is therefore important that authorities adopt an appropriate approach to risk management with regard to their investment activities.

45 Authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. Authorities should also consider carefully whether they can demonstrate value for money in borrowing in advance of need and can ensure the security of such funds.

46 **The local authority shall set and monitor against the specified prudential indicators for capital expenditure and external debt (paragraphs 73–74) in accordance with the due processes to be followed (paragraphs 25–38), the matters required to be taken into account (paragraphs 12–14), affordability (paragraphs 63–74), prudence (paragraphs 43–62) and in accordance with the definitions specified (paragraphs 75–87).**

47 Prudential indicators include indicative figures for years two and three to allow decisions to be made with an appreciation of future trends. It is recognised that these will be subject to change but exist to promote a move away from the focus on annual decision making towards longer-term strategies. Three year figures are also required to evidence that borrowing is for capital purposes.

CAPITAL EXPENDITURE

48 **Estimates of capital expenditure**

The local authority will make reasonable estimates of the total of capital expenditure that it plans to incur during the forthcoming financial year and at least the following two financial years. These prudential indicators will be referred to as estimates of capital expenditure and shall be expressed in the following manner:

> **Estimate of total capital expenditure to be incurred in years 1, 2 and 3 (and 4, etc if applicable)**

49 The estimates of capital expenditure will include any capital expenditure that it is estimated might be incurred (depending on option appraisals) and other relevant long-term liabilities.

50 **Actual capital expenditure**

After the year end, the actual capital expenditure incurred during the financial year will be recorded. This prudential indicator will be referred to as actual capital expenditure and shall be expressed as follows:

> **Actual capital expenditure for 20xx/20xx**

51 **Estimates of capital financing requirement**

The local authority will make reasonable estimates of the total capital financing requirement at the end of the forthcoming financial year and the following two years. These prudential indicators will be referred to as the estimates of capital financing requirement and shall be expressed as follows:

> **Estimate of capital financing requirement as at the end of years 1, 2 and 3**

52 The estimate of capital financing requirement at the end of each year will relate to all capital expenditure – ie it includes relevant capital expenditure incurred in previous years. The capital financing requirement will reflect the authority's underlying need to finance capital expenditure by borrowing or other long-term liability arrangements.

53 In order to make these estimates, the authority will need to consider all of the financing options available and estimate their use of these. The estimates will not commit the local authority to particular methods of financing. The chief finance officer will determine the actual financing of capital expenditure incurred once a year, after the end of the financial year.

54 **Actual capital financing requirement**

After the year end, the actual capital financing requirement will be calculated directly from the local authority's balance sheet. This prudential indicator will be referred to as the actual capital financing requirement and shall be expressed as follows:

> **Actual capital financing requirement as at xx/xx/xx**

EXTERNAL DEBT

55 **Authorised limit**

The local authority will set for the forthcoming financial year and the following two financial years an authorised limit for its total gross external debt, separately identifying borrowing from other long-term liabilities. This prudential indicator will be referred to as the authorised limit and shall be expressed in the following manner:

Authorised limit for external debt = authorised limit for borrowing + authorised limit for other long-term liabilities[5]

For years 1, 2 and 3

56 **Operational boundary**

The local authority will also set for the forthcoming financial year and the following two financial years an operational boundary for its total external debt, excluding investments, separately identifying borrowing from other long-term liabilities. This prudential indicator will be referred to as the operational boundary and shall be expressed in the following manner:

Operational boundary for external debt = operational boundary for borrowing + operational boundary for other long-term liabilities

For years 1, 2 and 3

57 Both the authorised limit and the operational boundary need to be consistent with the authority's plans for capital expenditure and financing; and with its treasury management policy statement and practices.

58 The operational boundary should be based on the authority's estimate of most likely, ie prudent, but not worst case scenario. Risk analysis and risk management strategies should be taken into account. The operational boundary should equate to the maximum level of external debt projected by this estimate. Thus, the operational boundary links directly to the authority's plans for capital expenditure; its estimates of capital financing requirement; and its estimate of cash flow requirements for the year for all purposes. The operational boundary is a key management tool for in-year monitoring – see in particular paragraph 40 of this Prudential Code, which includes the following:

It will probably not be significant if the operational boundary is breached temporarily on occasions due to variations in cash flow. However, a sustained or regular trend above the operational boundary would be significant and should lead to further investigation and action as appropriate.

59 Thus, both the operational boundary and the authorised limit will be based on the authority's plans. The authority will need to assure itself that these plans are affordable and prudent. The authorised limit will in addition need to provide headroom over and above the operational boundary sufficient for example for unusual cash movements.

5. Other long-term liabilities should be expanded to include all liabilities relating to PFI/PPP leases for both the operational limit and the authorised limit.

60 **Actual external debt**

After the year end, the closing balance for actual gross borrowing plus (separately) other long-term liabilities will be obtained directly from the local authority's balance sheet. This prudential indicator will be referred to as actual external debt and shall be expressed in the following manner:

> **Actual external debt as at xx/xx/xx = actual borrowing as at xx/xx/xx + actual other long-term liabilities as at xx/xx/xx**

61 The prudential indicator for actual external debt considers a single point in time and hence is only directly comparable to the authorised limit and operational boundary at that point in time. Actual debt during the year can be compared.

62 **Gross debt and the capital financing requirement**

In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. If in any of these years there is a reduction in the capital financing requirement, this reduction is ignored in estimating the cumulative increase in the capital financing requirement which is used for comparison with gross external debt. This is a key indicator of prudence. This prudential indicator will be referred to as gross debt and the capital financing requirement. Where the gross debt is greater than the capital financing requirement the reasons for this should be clearly stated in the annual treasury management strategy.

Affordability and prudential indicators for affordability

63 **The fundamental objective in the consideration of the affordability of the authority's capital plans is to ensure that the level of investment in capital assets proposed means that the total capital investment of the authority remains within sustainable limits.**

64 **In considering the affordability of its capital plans, the authority is required to consider all of the resources currently available to it/estimated for the future, together with the totality of its capital plans, income and expenditure forecasts.**

65 Affordability should be considered in the light of the authority's medium-term forecast and other fiscal strategies. Capital expenditure plans should be considered alongside the cost of past borrowing, maintenance requirements and planned disposals. The authority's MRP/loans fund repayment policy will have a critical impact on the overall affordability of new borrowing and for this reason it is important to look at affordability not just in the medium term but also over the life of the asset base or underlying debt.

66 **Where ringfenced resources or separate funds such as the HRA or Police Fund exist, affordability must be considered against those resources available to fund borrowing.**

67 Under combined authority arrangements affordability may need to be considered against combined authority resources and the impact on underlying authorities. Where debt or guarantees relating to LEPs, subsidiaries or other corporate and non-corporate bodies exist, the impact on the authority should be considered. In these cases the development of local indicators may be appropriate.

68 Several significant matters that are relevant to a consideration of affordability are listed below (NB: This is not intended to be an exhaustive list):

- To what extent resources are likely to be available to finance proposed capital expenditure immediately (capital receipts, grants and direct revenue contributions).
- The revenue consequences of proposed capital expenditure in both the medium and the long term. This may be any combination of increased revenue expenditure/revenue savings/increased revenue income.
- Estimates of total interest costs and interest receivable. These should be the estimates of the actual amounts of interest that will be expended and received, based on the authority's estimates for actual external debt.
- Existing expenditure commitments, both capital and revenue. This would by definition include PFI commitments, PPP schemes, financial guarantees, operating leases and all long-term revenue commitments including the level of reserves.
- Planned change to revenue income or expenditure, whether through growth or savings.

- How much flexibility the authority's capital expenditure plans leave for future spending priorities, whether capital or revenue.
- Contingent liabilities.
- The revenue consequences of retirement benefit obligations.
- The extent to which financing costs are supported by government grants or contributions from other bodies.
- The current requirements for minimum revenue provision (England and Wales)/loans fund repayments (Scotland), or whatever may supersede these arrangements in the future.

69 Where the authority has interests in companies or other similar related entities, the authority needs to have regard to its financial commitments and obligations to those companies/entities.[6]

70 In considering affordability, the authority needs to pay due regard to risk and uncertainty in relation to all the above matters. Risk analysis and risk management strategies should be taken into account.

71 **The authority shall ensure that the revenue implications of capital finance, including financing costs, are properly taken into account within option appraisal processes, the capital programme and the medium-term forecast. In assessing affordability the authority shall consider the council tax implications of its capital programme, borrowing and investment decisions. The local authority shall set and monitor prudential indicators as key indicators of affordability.**

72 It is recognised that indicators of affordability are best determined in the light of local constraints around precepts and ringfenced and statutory funds such as the HRA and Police Fund. Authorities are encouraged to use local indicators that reflect how capital finance is permitted to be financed locally. For example for those authorities with a HRA, the ratio of financing costs to revenue budget should be calculated within the HRA ringfence and an impact on rents calculated. In setting indicators, it should be recognised however that ultimately all debts of a local authority fall on the taxpayer.

73 **Estimates of financing costs to net revenue stream**

As a minimum, the local authority will estimate for the forthcoming financial year and the following two financial years the proportion of financing costs to net revenue stream. This prudential indicator shall be referred to as estimates of the proportion of financing costs to net revenue stream and shall be expressed in the following manner:

Estimate of financing costs ÷ estimate of net revenue stream x 100%

For years 1, 2 and 3

74 **Actual financing costs to net revenue stream**

After the year end, the proportion of financing costs to net revenue stream will be calculated directly from the local authority's comprehensive income and expenditure

6. Local authorities with interests in subsidiary or associated companies and joint ventures will also need to have regard to the group accounting requirements of proper accounting practice.

statement. This prudential indicator shall be referred to as actual proportion of financing costs to net revenue stream and shall be expressed in the following manner:

Actual financing costs ÷ actual net revenue stream x 100%

SECTION EIGHT

Definitions

75 **These definitions shall be used for all purposes connected with the Prudential Code, and in particular shall be used by the local authority in setting, revising and monitoring against its prudential indicators.**

76 It is intended that, throughout, the definitions used in respect of the Prudential Code will be consistent with proper accounting practices for local authorities. The development of proper accounting practices follows due process and consultation. It is important that the Prudential Code is aligned with these practices. Therefore, many of the definitions that follow cross-refer to amounts that are required to be included within a local authority's Statement of Accounts in accordance with proper accounting practices. Where changes to proper accounting practices significantly affect the prudential indicators this fact should be highlighted by the local authority when setting or revising the indicators. If any figures in the authority's Statement of Accounts that are used in prudential indicators are subject to audit qualification, this fact should be highlighted when any prudential indicators are set or revised.

77 **Borrowing**

In the Prudential Code, borrowing refers to actual external borrowing. Prudential indicators for actual figures for previous years should be taken from the local authority's balance sheets for those years, by aggregating the amounts for:

- borrowing repayable with a period in excess of 12 months
- borrowing repayable on demand or within 12 months.

This value should then be adjusted to exclude any accounting adjustments made including premiums and discounts, transactions costs, accrued interest and effective interest rate adjustments. The resulting value for borrowing should then be equal to the actual outstanding external borrowing at the end of the financial year.

Prudential indicators for current and future years should be calculated in a manner consistent with this definition.

NB: See also transferred debt (paragraph 87).

78 **Capital expenditure**

The definition of capital expenditure starts with all those items capitalised in accordance with proper accounting practice. To this must be added any items that have/will be capitalised in accordance with legislation that otherwise would not be capitalised. Prudential indicators for actual figures for previous years should be taken from the amounts capitalised as disclosed in the local authority's statutory accounts. Prudential indicators for current and future years should be calculated in a manner consistent with this definition. In Scotland, the definition of capital expenditure for Prudential Code purposes should include any expenditure for which

Scottish ministers have provided a '*consent to borrow*' under the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 and relevant finance circulars.

79 **Capital financing requirement**

Actual figures for capital financing requirement for previous years should be taken from the local authority's balance sheets for those years, by consolidating:

- tangible fixed assets (ie property, plant and equipment, investment properties and non-current assets held for sale)
- intangible assets
- long-term debtors relating to capital transactions (where applicable)
- any amounts carried as investments that were treated as capital expenditure under proper practice or applicable regulations
- Revaluation Reserve
- Capital Adjustment Account
- Donated Assets Account.

In addition, any other items on the local authority's balance sheet that relate to capital expenditure incurred should be included, but excluding the underlying liability – ie the underlying need for the equivalent to borrowing – for lease obligations, deferred purchases and similar arrangements in respect of long-term credit. (See in particular the definition of other long-term liabilities in paragraph 85.) Any items on the balance sheet that relate to prepayments for revenue items should not be included. Useable capital receipts that have not been applied to finance capital expenditure should not be included. Grants unapplied should also not be included.

NB: The capital financing requirement can be a negative figure.

Estimates for capital financing requirement for current and future years should be calculated in a manner consistent with the definition given above.

80 **Debt**

For the purposes of the Prudential Code, debt or gross debt refers to the sum of borrowing (see paragraph 65) and other long-term liabilities (see paragraph 73). It should be noted for authorities in England, Wales and Northern Ireland that the Local Government Act 2003 and the Local Government Finance (Northern Ireland) Act 2011 require credit arrangements to be treated as the borrowing of money for the purposes of determining the affordable borrowing limit and the imposition of borrowing limits. In Scotland credit arrangements are not treated as the borrowing of money but are recognised as an outstanding liability on the balance sheet and are considered to be a debt associated with capital financing. Within the Prudential Code borrowing is distinguished from other long-term liabilities in order to relate the prudential indicators directly to the balance sheet.

Net debt is debt which is net of investments (see paragraph 82).

81 **Financing costs**

Actual figures for financing costs for previous years should be those charges made to the General Fund made by aggregating:

- interest charged to the General Fund with respect to borrowing
- interest payable under finance leases and any other long-term liabilities
- gains and losses on the repurchase or early settlement of borrowing credited or charged to the amount to be met from government grants and local taxpayers
- interest and investment income
- amounts payable or receivable in respect of financial derivatives
- any amounts required for the statutory provision for the repayment of debt, currently minimum revenue provision (England and Wales), loans fund repayments and the repayment of other long-term liabilities – PFI and finance leases (Scotland) and General Fund charges for loan principal (Northern Ireland), plus any additional voluntary contributions
- any amounts for depreciation/impairment that are charged to the amount to be met from government grants and local taxpayers.

Estimates for financing costs for current and future years should be calculated in a manner consistent with this definition.

NB: See also transferred debt (paragraph 87).

82 **Investments**

Actual figures for investments for previous years should start with the sum of the amounts on the local authority's balance sheets[7] for:

- long-term investments
- short-term investments
- cash and cash equivalents.

This value should then be adjusted to exclude accrued interest, so that the resulting value is equal to the value of external investments including impairments.

Estimates for investments for current and future years should be calculated in a manner consistent with this definition.

83 **Net borrowing**

For the purposes of the Prudential Code, net borrowing refers to borrowing (see paragraph 77) net of treasury management investments (see paragraph 82).

NB: See also transferred debt (paragraph 87).

7. The balance sheet includes the assets and liabilities of all activities of the authority, excluding the pension, trust, common good (in Scotland) and similar funds administered for third parties; therefore investments held by these funds will not be included.

84 **Net revenue stream**

Actual figures for net revenue stream should be taken from the amounts in the local authority's comprehensive income and expenditure statement for:

- taxation and non-specific grant income.

Estimates for net revenue stream for current and future years should be the local authority's estimates of the amounts to be met from government grants and local taxpayers, using the equivalent figures from the local authority's original/revised budget where available.

85 **Other long-term liabilities**

'Other long-term liabilities' in this Code relate to the liabilities which are outstanding under credit arrangements (as defined by statute for authorities in England, Wales and Northern Ireland). The objective is to identify liabilities outstanding (other than borrowing) in relation to the financing of capital expenditure.

The definition of other long-term liabilities starts with the sum of the amounts on the face of the local authority's balance sheet that are classified as liabilities that are for periods in excess of 12 months, other than borrowing repayable within a period in excess of 12 months or liabilities that are for less than 12 months, for example during the last year of a PFI contract or finance lease. For clarification, amounts that relate to the Capital Adjustment Account, Financial Instruments Adjustment Account, Capital Grants Unapplied, Unequal Pay Back Pay Account, Revaluation Reserve, Pensions Reserve, Capital Receipts Reserve, Available-for-Sale Financial Instruments Reserve and Major Repairs Reserve (England and Wales – authorities with an HRA) are not included within the definition of other long-term liabilities for the purposes of the Prudential Code.

To the resultant figure must be added any amounts that are determined by legislation to be other long-term liabilities[8] that would otherwise not be so classified and from which must be subtracted any amounts that are determined by legislation not to be other long-term liabilities that would otherwise be so classified (referred to below as statutory adjustments). Deferred liabilities in respect of transferred debt should be treated in accordance with paragraph 87. Prudential indicators for previous years should be taken from the local authority's balance sheets as amended for any statutory adjustments. Prudential indicators for current and future years should be calculated in a manner consistent with this definition.

86 **Treasury management**

Treasury management has the same definition as in the CIPFA *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes*:

The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

87 **Transferred debt**

Some local authorities are managing debt that was transferred to them on reorganisation and which relates to a number of other organisations as well as themselves. While such

8 Credit arrangements under Part 1 of the Local Government Act 2003.

arrangements continue, such local authorities (ie those managing the transferred debt/borrowing to on-lend) should include these amounts in their prudential indicators, except only that:

(a) These amounts should be netted off when calculating debt for the purposes of paragraph 62 of this Prudential Code.

(b) When considering financing costs for paragraphs 73–74 of this Prudential Code, wherever possible financing costs arising from transferred debt should be excluded from the financing costs of the local authority that is managing the debt for other local authorities. This can be achieved by crediting income from the external organisation received in relation to the financing costs of the managed debt, in line with proper practices.

A local authority that is in the reverse of this position, ie for which another local authority holds debt managed in this way, should exclude these amounts from its prudential indicators, except only that:

(c) When considering financing costs for paragraphs 73–74 of this Prudential Code, wherever possible financing costs arising from transferred debt should be included within the financing costs of the local authority for which another local authority is managing its debt. This can be achieved by debiting amounts payable to the local authority managing the debt, in line with proper practice.

Borrowing undertaken in Scotland under Regulation 10 of the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 should be treated in the same way as transferred debt.

EAST HERTS COUNCIL

PERFORMANCE, AUDIT AND GOVERNANCE SCRUTINY COMMITTEE – 22 JANUARY 2019

REPORT BY EXECUTIVE MEMBER FOR FINANCE AND SUPPORT SERVICES

TREASURY MANAGEMENT AND ANNUAL INVESTMENT STRATEGY 2019-20

WARD(S) AFFECTED: NONE

Purpose/Summary of Report

The report sets out the proposed Treasury Management Strategy and Annual Investment Strategy for 2018-19, including the prudential indicators.

Where changes have been made to the revised Treasury Management Strategy and Annual Investment Strategy for 2019-20 or to the credit criteria for selection of investment counterparties approved for 2018-19, these have been referred to and discussed below.

RECOMMENDATION(S) FOR FOR PERFORMANCE, AUDIT AND GOVERNANCE COMMITTEE: to recommend to the Executive that:	
(A)	**The Treasury Management Strategy and Annual Investment Strategy, including the prudential indicators discussed in paragraphs 2.1 – 2.3 is agreed for submission to Elected Members (Audit and Governance Committee, Executive and Council).**
(B)	**The credit and counterparty risk management and approved countries list discussed in paragraphs 2.3 is**

	agreed for submission to Elected Members (Audit and Governance Committee, Executive and Council).

1.0 Background

1.1 Treasury management is defined as: 'The management of the Council's investments and cash flows, its banking arrangements, money market and capital transactions; the effective control of the risks associated with these activities; and the pursuit of optimum returns consistent with the Council's risk management policy for treasury management.'

1.2 This activity is supported by the council's appointed independent advisors – Link Asset Services.

1.3 The Council is required by regulations under the Local Government Act 2003 to approve a Treasury Management Strategy and Annual Investment Strategy each year and produce a treasury management mid-year review of activities and prudential and treasury indicators for 2018/19.

1.4 The Strategy sets out a risk management policy for the investment of surplus cash. The Strategy is designed to obtain the highest possible yield, contingent upon investments being secure, and there being sufficient liquidity to meet the Council's daily cash needs.

1.5 This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

2.0 Report

2.1 Please refer to the recommended Treasury Management Strategy and Annual Investment Strategy in **Essential**

Reference Paper 'B': Treasury Management Strategy and Annual Investment Strategy 2019-20,

2.2 Prudential Indicators are included in Essential Reference Paper 'B': Treasury Management Strategy and Annual Investment Strategy 2017-18 paragraphs 2.1, 2.2, 2.3, 3.1, 3.2, and 5.1. Note cost of borrowing and MRP information to follow at a future date.

2.3 Please refer to the Credit and Counterparty Risk Management paragraph 5.4 and Approved Countries List paragraph 5.5.

2.2 Revised reporting is required for the 2019/20 reporting cycle due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011.

3.0 Implications/Consultations

3.1 Information on any corporate issues and consultation associated with this report can be found within **Essential Reference Paper 'A'**.

Background Papers
CIPFA Code of Practice on Treasury Management (2018/19)
CIPFA Prudential Code for Capital Finance in Local Authorities (2017)
MHCLG Investment Guidance
MHCLG Minimum Revenue Provision (MRP) Guidance

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IMPLICATIONS/CONSULTATIONS

Contribution to the Council's Corporate Priorities/ Objectives*:*	Priority 1 – Improve the health and wellbeing of our communities Priority 2 – Enhance the quality of people's lives Priority 3 – Enable a flourishing local economy
Consultation:	Not Applicable
Legal:	The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (Treasury Management Strategy Statement, annual and midyear reports). This report therefore ensures this Council is implementing best practice in accordance with the Code. The report fulfils the following legislative requirements: • Reporting of prudential Indicators in line with the requirements of the CIPFA Code of Practice. • Reporting to those charged with governance a mid-year treasury management report.
Financial:	Within the body of the report.
Human Resource:	Not Applicable
Risk Management:	Within the body of the report.
Health and wellbeing – issues and	Not Applicable

impacts:	
Equality Impact Assessment required:	No

East Herts District Council

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

English non-HRA local authorities
2019/20

Including commercial activities / non treasury investments

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1.INTRODUCTION

1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day to day treasury management activities.

CIPFA defines treasury management as:

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

Revised reporting is required for the 2019/20 reporting cycle due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately.

1.2 Reporting requirements

1.2.1 Capital Strategy

The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019-20, all local authorities to prepare an additional report, a capital strategy report, which will provide the following:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risk is managed; and
- the implications for future financial sustainability.

The aim of this capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset. The capital strategy will show:

- The corporate governance arrangements for these types of activities;
- Any service objectives relating to the investments;
- The expected income, costs and resulting contribution;
- The debt related to the activity and the associated interest costs;
- The payback period (MRP policy);
- For non-loan type investments, the cost against the current market value;
- The risks associated with each activity.

Where a physical asset is being bought, details of market research, advisers used, (and their monitoring), ongoing costs and investment requirements, and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash.

Where the Council has borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and why the MHCLG Investment Guidance and CIPFA Prudential Code have not been adhered to.

If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy.

To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this report.

1.2.2 Treasury Management Reporting

The Council is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.

a. Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report is forward looking and covers:

- the capital plans, (including prudential indicators);
- a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
- an investment strategy, (the parameters on how investments are to be managed).

b. A mid-year treasury management report – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

c. An annual treasury report – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Performance, Audit and Governance Scrutiny Committee.

1.3 Treasury Management Strategy for 2019/20

The Strategy for 2019/20 covers two main areas:

Capital issues

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

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;

- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, MHCLG MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training will be arranged as required. The training needs of treasury management officers are periodically reviewed, with relevant seminars and workshops regularly attended.

1.5 Treasury management consultants

The Council uses Link Asset Services Treasury Solutions as its external treasury management advisors.

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

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

The scope of investments within the Council's operations now includes both conventional treasury investments, (the placing of residual cash from the Council's functions), and more commercial type investments, such as investment properties.

2 THE CAPITAL PRUDENTIAL INDICATORS 2019/20 – 2021/22

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

2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

Capital expenditure £m	2017/18 Actual	2018/19 Estimate (Dec/18)	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Services	**2.4**	**6.0**	**40.6**	**23.1**	**1.8**
Commercial activities/ non-financial investments *	**0.0**	**5.1**	**19.8**	**2.3**	**4.0**
Total	**2.4**	**11.1**	**60.4**	**25.4**	**5.8**

* Commercial activities / non-financial investments relate to areas such as capital expenditure on investment properties, loans to third parties etc.

Other long-term liabilities - The above financing need excludes other long-term liabilities, such as PFI and leasing arrangements that already include borrowing instruments.

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

Financing of capital expenditure £m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Capital receipts	1.1	4.6	0.8	0.8	0.8
Capital grants	0.3	4.9	4.9	0.0	0.0
Capital reserves	0.2	1.6	0.3	0.3	0.3
Revenue	0.8	0.0	0.0	0.0	0.0
Net financing need for the year	**0.0**	**0.0**	**54.1**	**24.3**	**5.8**

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

Commercial activities / non-financial investments £m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Capital Expenditure	0.0	5.1	19.8	2.3	4.0
Financing costs	0.0	0.0	0.0	0.0	0.0
Net financing need for the year	**0.0**	**0.0**	**14.9**	**2.3**	**4.0**
Percentage of total net financing need %	**0%**	**0%**	**27.54%**	**9.05%**	**68.96%**

2.2 The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long-term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes. The Council currently has no such schemes within the CFR.

The Council is asked to approve the CFR projections below:

£m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Capital Financing Requirement					
Total CFR	**(23.1)**	**(23.1)**	**31.0**	**55.3**	**61.1**
Net financing need for the year (above)	0	0	54.1	24.3	5.8
Movement in CFR	**0**	**0**	**54.1**	**24.3**	**5.8**

A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures shown in 2.1 and the details above demonstrate the scope of this activity and, by approving these figures, consider the scale proportionate to the Authority's remaining activity.

2.3 Core funds and expected investment balances

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

Year End Resources £m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Fund balances / reserves	16.6	12.0	12.0	12.0	12.0
Capital receipts	1.1	0.0	0.0	0.0	0.0
Provisions	0.0	0.0	0.0	0.0	0.0
Other	0.5	0.0	0.0	0.0	0.0
Total core funds	**18.2**	**12.0**	**12.0**	**12.0**	**12.0**
Working capital*	33.7	**33.7**	**(20.4)**	**(44.7)**	**(50.5)**
Under/over borrowing	7.5	7.5	17.5	41.5	51.5
Expected investments	**59.4**	**53.2**	**9.1**	**8.8**	**13.0**

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

2.4 Minimum revenue provision (MRP) policy statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

MHCLG regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision.

Following the disposal of the Council's Housing stock, the calculated MRP is now nil but is now under review due to the forward capital programme and will be reported separately

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The overall treasury management portfolio as at 31 March 2018 and for the position as at 30 November 2018 are shown below for both borrowing and investments.

TREASURY PORTFOLIO				
	actual	actual	current	current
	31.3.18	**31.3.18**	**30.11.18**	**30.11.18**
Treasury investments	£000	%	£000	%
banks	27,675	42%	37,145	53%
building societies - unrated	0	0%	0	0%
building societies - rated	0	0%	1,600	2%
local authorities	6,000	9%	0	0%
DMADF (H.M.Treasury)	0	0%	0	0%
money market funds	4,130	6%	3,620	5%
certificates of deposit	6,000	9%	7,800	11%
Total managed in house	**43,805**	**67%**	**50,165**	**71%**
bond funds	2,000	3%	0	0%
property funds	20,000	30%	20,000	29%
Total managed externally	**22,000**	**33%**	**20,000**	**29%**
Total treasury investments	**65,805**	**100%**	**70,165**	**100%**
Treasury external borrowing				
local authorities	0	0%	0	0%
PWLB	1,500	20%	1,500	20%
LOBOs	0	0%	0	0%
BOND	6,000	80%	6,000	80%
Total external borrowing	**7,500**	**100%**	**7,500**	**100%**
Net treasury investments / (borrowing)	**58,305**	**0**	**62,665**	**0**

The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
External Debt					
Debt at 1 April	7.5	7.5	7.5	17.5	41.5
Expected change in Debt	0.0	0.0	10.0	24.0	10.0
Other long-term liabilities (OLTL)	0.0	0.0	0.0	0.0	0.0
Expected change in OLTL	0.0	0.0	0.0	0.0	0.0
Actual gross debt at 31 March	**7.5**	**7.5**	**17.5**	**41.5**	**51.5**
The Capital Financing Requirement	**(23.1)**	**(23.1)**	**31.0**	**55.3**	**61.1**
Under / (over) borrowing	**(7.5)**	**(7.5)**	**13.5**	**13.8**	**9.6**

Within the above figures the level of debt relating to commercial activities / non-financial investment is:

	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
External Debt for commercial activities / non-financial investments					
Actual debt at 31 March £m	**0.0**	**0.0**	**14.9**	**17.2**	**21.2**
Percentage of total external debt %	**0.0%**	**0.0%**	**85.14%**	**41.45%**	**41.16%**

Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Director of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational boundary £m	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Debt	7.5	31.0	55.3	61.1
Other long term liabilities	0.0	0.0	0.0	0.0
Total	7.5	31.0	55.3	61.1

The authorised limit for external debt. This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following authorised limit:

Authorised limit £m	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Debt	7.5	36.0	60.3	66.1
Other long term liabilities	2.0	5.0	5.0	5.0
Total	9.5	41.0	65.3	71.1

CAPITAL FINANCING REQUIREMENT including PFI and finance leases											
	Actual	Est	Est	Est	Est	Est	Est	Est	Est	Est	Est
	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
GF CFR	-23.1	-23.1	16.1	53.0	57.1	61.1	61.1	61.1	61.1	61.1	61.1
Commercial activity / non financial investments	0.0	0.0	14.9	2.3	4.0						
Total CFR	**-23.1**	**-23.1**	**31.0**	**55.3**	**61.1**	**61.1**	**61.1**	**61.1**	**61.1**	**61.1**	**61.1**
External Borrowing	7.5	7.5	17.5	41.5	51.5	51.5	51.5	51.5	51.5	51.5	51.5
Other long term liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Debt	**7.5**	**7.5**	**17.5**	**41.5**	**51.5**	**51.5**	**51.5**	**51.5**	**51.5**	**51.5**	**51.5**
Authorised Limit	9.5	9.5	41.0	65.3	71.1	71.1	71.1	71.1	71.1	71.1	71.1
Operational Boundary	7.5	7.5	31.0	55.3	61.1	61.1	61.1	61.1	61.1	61.1	61.1

3.3 Prospects for interest rates

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

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

The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth became increasingly strong during 2018 until slowing significantly during the last quarter. At their November quarterly Inflation Report meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We therefore saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity prices as they sold out of holding riskier assets. However, by early January 2019, US 10 year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession. Equity prices have been very volatile on alternating good and bad news during this period.

From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

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

Investment and borrowing rates

- Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.
- Borrowing interest rates have been volatile so far in 2018-19 and while they were on a rising trend during the first half of the year, they have backtracked since then until early January. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;
- There will remain a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

3.4 Borrowing strategy

The Council is currently in a negative CFR position. This means that the capital borrowing need (the Capital Financing Requirement), has not been reached due to the level of the Council's reserves.

Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Head of Strategic Finance and Property will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

Any decisions which will result in a significant change to the CFR and this Council's need to borrow, will be reported to Full Council at the next available opportunity.

3.5 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.6 Debt rescheduling

No debt rescheduling will be undertaken in 2019/20.

3.7 Municipal Bond Agency

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority may make use of this new source of borrowing as and when appropriate.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy – management of risk

The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate ERP).

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

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

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

The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as **"credit default swaps"** and overlay that information on top of the credit ratings.
3. **Other information sources** used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in appendix 5.4 under the categories of 'specified' and 'non-specified' investments.

- **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

5. **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being 50% of the total investment portfolio, (see paragraph 4.3).
6. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2.
7. **Transaction limits** are set for each type of investment in 4.2.
8. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 4.4).
9. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 4.3).
10. This authority has engaged **external consultants**, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.
11. All investments will be denominated in **sterling**.
12. As a result of the change in accounting standards for 2018/19 under **IFRS 9,** this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18.)

However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year.

The above criteria *are* unchanged from last year.

4.2 Creditworthiness policy

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

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

This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands*:*

- Yellow 5 years *
- Dark pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
- Light pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

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

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

All credit ratings will be monitored. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service.

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

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

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

	Colour (and long term rating where applicable)	Money Limit	Time Limit	Time Limit
Banks *	yellow	£10m	5yrs	£10m
Banks	purple	£10m	2 yrs	£10m
Banks	orange	£10m	1 yr	£10m
Banks – part nationalised	blue	£20m	1 yr	£20m
Banks	red	£10m	6 mths	£10m
Banks	green	£10m	100 days	£10m
Banks	No colour	Not to be used		Not to be used
Limit 3 category – Council's banker (where "No Colour")	XXX	£20m	1 day	£20m
Property Funds	-	£20m	Not a fixed term investment so no time limit	£20m
DMADF	UK sovereign rating	unlimited	6 months	unlimited
Local authorities	n/a	£10m / %	5yrs	£10m / %
	Fund rating	**Money Limit**	**Time Limit**	**Time Limit**
Money Market Funds CNAV	AAA	£10m / %	liquid	liquid
Money Market Funds LVNAV	AAA	£10m / %	liquid	liquid
Money Market Funds VNAV	AAA	£10m / %	liquid	liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	Dark pink / AAA	£10m / %	liquid	liquid
Ultra-Short Dated Bond Funds with a credit score of 1.50	Light pink / AAA	£10m / %	liquid	liquid

UK banks – ring fencing

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

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

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

4.3 Country limits

Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors.

a) **Non-specified investment limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being 50% of the total investment portfolio.

b) **Country limit.** The Council has determined that it will only use approved counterparties from the UK and from countries with a **minimum sovereign credit rating of AA-** from Fitch *(or equivalent*). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.6. This list will be added to, or deducted from, by Officers should ratings change in accordance with this policy.

c) **Other limits.** In addition:

- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

4.4 Investment strategy

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations.

On the assumption that the UK and EU agree a Brexit deal in spring 2019, then Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 - 0.75%
- 2019/20 - 1.25%
- 2020/21 - 1.50%
- 2021/22 - 2.00%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

	Now
2018/19	0.75%
2019/20	1.00%
2020/21	1.50%
2021/22	1.75%
2022/23	1.75%
2023/24	2.00%
Later years	2.50%

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are dependent on how strong GDP growth turns

out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

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

The Council is asked to approve the following treasury indicator and limit:

Upper limit for principal sums invested for longer than 365 days			
Principal sums invested for longer than 365 days as at Dec 18	**2019/20**	**2020/21**	**2021/22**
£m	£m	£m	£m
20.0	40.0	40.0	40.0

Against this view, the Treasury Officers expect for its cash flow generated balances, the Council will seek to utilise its instant access and notice accounts, money market funds and short-dated deposits, in order to benefit from the compounding of interest.

4.5 Investment risk benchmarking

This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day, 1, 3, 6 or 12 month LIBID uncompounded.

4.6 End of year investment report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

5 APPENDICES

1. Prudential and treasury indicators and MRP statement
2. Interest rate forecasts
3. Economic background
4. Treasury management practice 1 – credit and counterparty risk management
5. Approved countries for investments
6. Treasury management scheme of delegation
7. The treasury management role of the section 151 officer

5.1 THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2019/20 – 2021/22 AND MRP STATEMENT

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

5.1.1 Capital expenditure

Capital expenditure £m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Services	2.4	6.0	40.6	23.1	1.8
Commercial activities / non-financial investments	0.0	5.1	19.8	2.3	4.0
Total	**2.4**	**11.1**	**60.4**	**25.4**	**5.8**

5.1.2 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The estimated borrowing, cost of borrowing and MRP are currently being worked on, Council will be asked to approve the following indicators at a future date:

Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

5.1.3 Maturity structure of borrowing

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

5.1.5. Control of interest rate exposure

Please see paragraphs 3.3, 3.4 and 4.4.

5.2 APPENDIX: Interest Rate Forecasts 2019 – 2022

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Link Asset Services Interest Rate View	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%
Bank Rate													
Link Asset Services	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
Capital Economics	0.75%	1.00%	1.25%	1.50%	1.70%	1.75%	2.00%	2.00%	-	-	-	-	-
5yr PWLB Rate													
Link Asset Services	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
Capital Economics	2.03%	2.15%	2.40%	2.65%	2.70%	2.75%	2.80%	2.85%	-	-	-	-	-
10yr PWLB Rate													
Link Asset Services	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
Capital Economics	2.43%	2.55%	2.80%	3.05%	3.05%	3.05%	3.05%	3.05%	-	-	-	-	-
25yr PWLB Rate													
Link Asset Services	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
Capital Economics	2.96%	3.08%	3.33%	3.58%	3.53%	3.48%	3.43%	3.38%	-	-	-	-	-
50yr PWLB Rate													
Link Asset Services	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%
Capital Economics	2.78%	2.90%	3.15%	3.40%	3.40%	3.40%	3.40%	3.40%	-	-	-	-	-

5.3 ECONOMIC BACKGROUND

GLOBAL OUTLOOK. World growth has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China and the eurozone, overall world growth is likely to weaken.

Inflation has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to a marked acceleration of wage inflation. The US Fed has therefore increased rates nine times and the Bank of England twice. However, the ECB is unlikely to start raising rates until late in 2019 at the earliest.

KEY RISKS - central bank monetary policy measures
Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as quantitative easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation, is coming towards its close. A new period is well advanced in the US, and started more recently in the UK, of reversing those measures i.e. by raising central rates and, (for the US), reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of a reduction in spare capacity in the economy and of unemployment falling to such low levels, that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously. This meant that both asset categories were exposed to the risk of a sharp downward correction and we have indeed, seen a sharp fall in equity values in the last quarter of 2018. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery, by taking too rapid and too strong action, or, conversely, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.**

At the time of writing, (early January 2019), financial markets are very concerned that the Fed is being too aggressive with its policy for raising interest rates and was likely to cause a recession in the US economy.

The world economy also needs to adjust to a sharp change in **liquidity creation** over the last five years where the US has moved from boosting liquidity by QE purchases, to reducing its holdings of debt, (currently about $50bn per month). In addition, the European Central Bank ended its QE purchases in December 2018.

UK. The flow of positive economic statistics since the end of the first quarter of 2018 has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in quarter 2 and by a strong performance in quarter 3 of +0.6%. However, growth in quarter 4 is expected to weaken significantly.

At their November quarterly Inflation Report meeting, the MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years time, but declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also *raise* Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor could potentially provide fiscal stimulus to support economic growth, though at the cost of increasing the budget deficit above currently projected levels.

It is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel will take well into spring 2019. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019, (on the assumption that a Brexit deal is agreed by both the UK and the EU). The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.

Inflation. The Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.3% in November. In the November Bank of England quarterly Inflation Report, inflation was forecast to still be marginally above its 2% inflation target two years ahead, (at about 2.1%), given a scenario of minimal increases in Bank Rate. This inflation forecast is likely to be amended upwards due to the Bank's report being produced prior to the Chancellor's announcement of a significant fiscal stimulus in the Budget; this is likely to add 0.3% to GDP growth at a time when there is little spare capacity left in the economy, particularly of labour.

As for the **labour market** figures in October**,** unemployment at 4.1% was marginally above a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 3.3%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates less CPI inflation), earnings are currently growing by about 1.0%, the highest level since 2009. This increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC was right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

In the **political arena**, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to reaching an orderly Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

USA. President Trump's massive easing of fiscal policy is fuelling a, (temporary), boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. The strong growth in employment numbers, and the reduction in the unemployment rate to 3.9% near to a recent 49 year low, has fed through to an upturn in wage inflation which hit 3.2 % in November. However, CPI inflation overall fell to 2.2% in November and looks to be on a falling trend to drop below the Fed's target of 2% during 2019. The Fed has continued on its series of increases in interest rates with another 0.25% increase in December to between 2.25% and 2.50%, this being the fifth increase in 2018 and the ninth in this cycle. However, they did also reduce their forecast for further increases from three to two. This latest increase compounded investor fears that the Fed is over doing the rate and level of increases in rates and that it is going to cause a US recession as a result. There is also much evidence in previous monetary policy cycles, of the Fed's series of increases doing exactly that. Consequently, we have seen stock markets around the world plunging under the weight of fears around the Fed's actions, the trade war between the US and China, an expectation that world growth will slow, Brexit etc.

The tariff war between the US and China has been generating a lot of heat during 2018, but it is not expected that the current level of actual action would have much in the way of a significant effect on US or world growth. However, there is a risk of escalation if an agreement is not reached soon between the US and China.

Eurozone. Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this was probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of nearly 2% for 2018, the horizon is less clear than it seemed just a short while ago. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank ended all further purchases in December 2018. The ECB is forecasting inflation to be a little below its 2% top limit through the next three years so it may find it difficult to warrant a start on raising rates by the end of 2019 if the growth rate of the EU economy is on a weakening trend.

China. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. There are concerns that official economic statistics are inflating the published rate of growth.

Japan. The country has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

Emerging countries. Argentina and Turkey are currently experiencing major headwinds and are facing challenges in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy, (around 1% each), so the fallout from the expected recessions in these countries will be minimal.

INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 3.2, are predicated on an assumption of an agreement being reached on Brexit between the UK and the EU. In the event of an orderly non-agreement exit, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation.

This is also likely to cause short to medium term gilt yields to fall. If there was a disorderly Brexit, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for ten years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England monetary policy** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **eurozone sovereign debt crisis**, possibly in **Italy**, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. The EU rejected the initial proposed Italian budget and demanded cuts in government spending which the Italian government initially refused. However, a fudge was subsequently agreed, but only by *delaying* the planned increases in expenditure to a later year. This can has therefore only been kicked down the road to a later time. The rating agencies have started on downgrading Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold it. Unsurprisingly, investors are becoming increasingly concerned by the words and actions of the Italian government and consequently, Italian bond yields

have risen – at a time when the government faces having to refinance large amounts of debt maturing in 2019.

- Weak capitalisation of some **European banks**. Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian government debt - debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.
- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD is reviewing whether it can continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018, (a new party leader has now been elected). However, this makes little practical difference as she is still expected to aim to continue for now as the Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.
- **Other minority eurozone governments.** Spain, Portugal, Ireland, the Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile. Sweden is also struggling to form a government due to the anti-immigration party holding the balance of power, and which no other party is willing to form a coalition with. The Belgian coalition collapsed in December 2018 but a minority caretaker government has been appointed until the May EU wide general elections.
- **Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU while **Italy,** in 2018, also elected a strongly anti-immigration government. Elections to the EU parliament are due in May/June 2019.
- Further increases in interest rates in the US could spark a **sudden flight of investment funds** from more risky assets e.g. shares, into bonds yielding a much improved yield. Throughout the last quarter of 2018, we saw sharp falls in equity markets interspersed with occasional partial rallies. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.
- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many

large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.

- **Geopolitical risks,** especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- **Brexit** – if both sides were to agree a compromise that removed all threats of economic and political disruption.
- **The Fed causing a sudden shock in financial markets** through misjudging the pace and strength of increases in its Fed Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation,** whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

<u>Brexit timetable and process</u>

March 2017	UK government notified the European Council of its intention to leave under the Treaty on European Union Article 50 on 29 March 2019
25.11.18	EU27 leaders endorsed the withdrawal agreement
Dec 2018	vote in the UK Parliament on the agreement was postponed
21.12.18 – 8.1.19	UK parliamentary recess
14.1.19	vote in Parliament on a 'no deal' scenario
By 29.3.19	second vote (?) in UK parliament if first vote rejects the deal
By 29.3.19	if the UK Parliament approves a deal, then ratification by the EU Parliament requires a simple majority
By 29.3.19	if the UK and EU parliaments agree the deal, the EU Council needs to approve the deal; 20 countries representing 65% of the EU population must agree

29.3.19 UK leaves the EU, (or asks the EU for agreement to an extension of the Article 50 period if the UK Parliament rejects the deal and no deal departure?)

29.3.19: if an agreement is reached with the EU on the terms of Brexit, then this will be followed by a proposed **transitional period ending around December 2020.**

- UK continues as a full EU member until March 2019 with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy may leave the single market and tariff free trade at different times during the transitional period.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK could also exit without any such agreements in the event of a breakdown of negotiations.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On full exit from the EU: the UK parliament would repeal the 1972 European Communities Act.

5.4 TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

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

NON-SPECIFIED INVESTMENTS: These are any investments that do not meet the specified investment criteria. A maximum of 75% ** will be held in aggregate in non-specified investment.

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

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	Minimum credit criteria / colour band	** Max % of total investments/ £ limit per institution	Max. maturity period
DMADF – UK Government	N/A	100%	No Max
UK Government gilts	UK sovereign rating	100%	12 months
UK Government Treasury bills	UK sovereign rating	100%	12 months
Bonds issued by multilateral development banks	AAA (or state your criteria if different)	40%	12 months
Money Market Funds CNAV	AAA	95%	Liquid
Money Market Funds LNVAV	AAA	95%	Liquid
Money Market Funds VNAV	AAA	95%	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	AAA	95%	Liquid

Ultra-Short Dated Bond Funds with a credit score of 1.5	AAA	95%	Liquid
Local authorities	N/A	100%	12 months
Term deposits with housing associations	Green	80%	12 months
Term deposits with banks and building societies	Green	95%	12 months
CDs or corporate bonds with banks and building societies	Green	100%	12 months
Gilt funds	UK sovereign rating	100%	12 Months

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

NON-SPECIFIED INVESTMENTS: A maximum of 75% ** will be held in aggregate in non-specified investment.

1. Maturities of ANY period

	* Minimum Credit Criteria	Use	** Max % of total investme nts	Max. maturity period
Fixed term deposits with variable rate and variable maturities: - Structured deposits	Green	In-house and Fund Managers	80%	As per minimum credit Criteria
Certificates of deposit issued by banks and building societies	Green	In-house and Fund Managers	80%	As per minimum credit Criteria
Fixed Bonds – Corporate, Financial, Supranational or Covered.	AAA	In-house and Fund Managers	10%	5 years
Floating rate notes	AAA	In house and Fund Managers	10%	5 years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)				
Corporate bond fund	AAA	In house and Fund Managers	10%	5 years
Property fund:	Based on external credit assessment from the Council's Treasury Management Advisors. UK asset investment.	In house and Fund Managers	£20m at fund entry. Maximum of two Funds at any one time for viability.	Long Term

2. Maturities in excess of 1 year

	* Minimum Credit Criteria	Use	** Max % of total investments	Max. maturity period
Term deposits – local authorities	--	In-house	80%	5 years
Term deposits – banks and building societies	Green	In-house	80%	5 years
Certificates of deposit issued by banks and building societies	Green	In-house and Fund Managers	80%	5 years
UK Government Gilts	UK sovereign rating	In-house and Fund Managers	80%	10 years
Fixed Bonds – Corporate, Financial, Supranational or Covered.	AAA	In-house and Fund Managers	10%	5 years
Sovereign bond issues (other than the UK govt)	AAA	In-house and Fund Managers	50%	10 years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)				
Property fund	Based on external credit assessment from the Council's Treasury Management Advisors. UK asset investment.	In house and Fund Managers	£20m at fund entry. Maximum of two Funds at any one time for viability.	Long Term

5.5 APPROVED COUNTRIES FOR INVESTMENTS

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link Asset Services credit worthiness service.

Based on lowest available rating

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Hong Kong
- U.K.

AA-

- Belgium
- Qatar

N.B. THIS LIST IS AS AT 4.12.18

5.6 TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) Full council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

(ii) Executive / full council

- approval of/amendments to the organisation’s adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Performance, Audit and Governance Scrutiny Committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

5.7 THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The S151 (responsible) officer *(see TM Code page 38 (iv))*

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following *(TM Code p54): -*

- *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*

- *Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;*

- *Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;*

- *Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;*

- *Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.*

STATUTORY GUIDANCE ON LOCAL GOVERNMENT INVESTMENTS

(3rd Edition)

Issued under section 15(1)(a) of the *Local Government Act 2003* and effective for financial years commencing on or after 1 April 2018

POWER UNDER WHICH THE GUIDANCE IS ISSUED

1. The following Guidance is issued by the Secretary of State under section 15(1)(a) of the *Local Government Act 2003.* Under that section local authorities are required to "have regard" to "such guidance as the Secretary of State may issue".

DEFINITION OF TERMS

2. In this guidance the ***2003 Act*** means the *Local Government Act 2003.*

3. **Local authority** has the meaning given in section 23 of the *2003 Act.* To the extent that this guidance applies to parish councils and charter trustees (see paragraph 11) a reference to a local authority includes those councils and trustees.

4. The definition of an **investment** covers all of the financial assets of a local authority as well as other non-financial assets that the organisation holds primarily or partially to generate a profit; for example, investment property portfolios. This may therefore include investments that are not managed as part of normal treasury management processes or under treasury management delegations.

5. For the avoidance of doubt, the definition of an investment also covers loans made by a local authority to one of its wholly-owned companies or associates, to a joint venture, or to a third party. The term does not include *pension funds* or *trust fund investments,* which are subject to separate regulatory regimes and therefore are not covered by this guidance.

6. A **credit rating agency** is one of the following three companies:
   - Standard and Poor's;
   - Moody's Investors Service Ltd; and
   - Fitch Ratings Ltd.

7. For the purposes of this guidance a **loan** is a written or oral agreement where a local authority temporarily transfers cash to a third party, joint venture, subsidiary or associate who promises to return it according to the terms of the agreement, normally with interest. This definition does not include a loan to another local authority, which is classified as a specified investment.

8. The **Treasury Management Code** means the statutory code of practice issued by CIPFA: *"Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, 2017 Edition".*

9. The **Prudential Code** means the statutory code of practice, issued by CIPFA: *"The Prudential Code for Capital Finance in Local Authorities, 2017 Edition".*

10. The **Capital Strategy** is the strategy required by the updates to the Prudential Code and Treasury Management Code.

APPLICATION

Effective date

11. This guidance applies for financial years commencing on or after 1 April 2018. It supersedes all previous editions of the Statutory Guidance on Local Authority Investments.

12. Strategies presented to Council or equivalent before 1 April 2018 but relating to 2018-19 and future financial years do not need to include all of the additional disclosures required by this edition of the guidance should it not prove practical or cost effective to do so. If a local authority chooses not to include the new disclosures in its 2018-19 Strategy, it must include the disclosures in full in the first Strategy presented to full Council or equivalent after 1 April 2018.

Local authorities

13. This guidance applies to all local authorities in England.

14. This guidance applies to parish councils and charter trustees, providing their total investments exceed or are expected to exceed £100,000 at any time during the financial year. Where a parish council or charter trustee expects its total investments to be between £10,000 and £100,000, it is encouraged to adopt the principles in this guidance.

KEY PRINCIPLES

Transparency and democratic accountability

15. For each financial year, a local authority should prepare at least one Investment Strategy ("the Strategy"). The Strategy should contain the disclosures and reporting requirements specified in this guidance.

16. The Strategy should be approved by the full council. For authorities without a full Council, the Strategy should be approved at the closest equivalent level. The

Secretary of State recommends that the Strategy should be presented for approval prior to the start of the financial year.

17. Where a local authority proposes to make a material change to its Strategy during the year a revised Strategy should be presented to full council or equivalent for approval before the change is implemented.

18. The Strategy should be publicly available on a local authority's website. Where a parish council or charter trustee does not maintain its own website, they should post a public notice detailing how local residents can obtain a copy of the Strategy, free of charge.

19. Where a local authority prepares a Capital Strategy in line with the requirements of the Prudential Code, a Treasury Management Strategy in line with the requirements of the Treasury Management Code, or any other publicly available document, the disclosures required to be included in the Strategy can be published in those documents instead of in the Strategy.

Contribution

20. Investments made by local authorities can be classified into one of two main categories:
    - Investments held for treasury management purposes; and
    - Other investments.

21. Where local authorities hold treasury management investments, they should apply the principles set out in the Treasury Management Code. They should disclose that the contribution that these investments make to the objectives of the local authority is to support effective treasury management activities. The only other element of this Guidance that applies to treasury management investments is the requirement to prioritise Security, Liquidity and Yield in that order of importance.

22. Local authorities should disclose the contribution that all other investments make towards the service delivery objectives and/or place making role of that local authority. It is for each local authority to define the types of contribution that investments can make and a single investment can make more than one type of contribution.

Use of indicators

23. The Strategy should include quantitative indicators that allow Councillors and the public to assess a local authority's total risk exposure as a result of its investment decisions. This should include how investments are funded and the rate of return

received. Where investment decisions are funded by borrowing the indicators used should reflect the additional debt servicing costs taken on.

24. Local authorities should consider the most appropriate indicators to use, given their risk appetite and capital and investment strategies. Whilst this guidance does not prescribe specific indicators or thresholds, the indicators used should be consistent from year to year and should be presented in a way that allows elected members and the general public to understand a local authorities' total risk exposure from treasury management and other types of investment.

25. Where a local authority has entered into a long term investment or has taken out long term debt to finance an investment the indicators used should allow Councillors and the general public to assess the risks and opportunities of the investment over both its payback period and over the repayment period of any debt taken out.

Security, Liquidity and Yield

26. A prudent investment policy will have two underlying objectives:
    - **Security** – protecting the capital sum invested from loss; and
    - **Liquidity** – ensuring the funds invested are available for expenditure when needed.

27. The generation of **yield** is distinct from these prudential objectives. However, this does not mean that local authorities are recommended to ignore potential revenues. Once proper levels of security and liquidity are determined, it will then be reasonable to consider what yield can be obtained consistent with these priorities.

28. When entering into treasury management investments, local authorities should consider security, liquidity and yield in that order of importance.

29. When entering into other types of investments local authorities should consider the balance between security, liquidity and yield based on their risk appetite and the contribution(s) of that investment activity.

Security

<u>Financial Investments</u>

30. Financial investments can fall into one of three categories:
    - **Specified investments**;
    - **Loans**; and
    - Other **Non-specified investments**.

<u>Specified Investments</u>

31. An investment is a specified investment if all of the following apply:
    - The investment is denominated in sterling and any payments or repayments in the respect of the investment are payable only in sterling.
    - The investment is not a long term investment. This means that the local authority has contractual right to repayment within 12 months, either because that is the expiry term of the investment or through a non-conditional option.
    - The making of the investment is not defined as capital expenditure by virtue of Regulation 25(1)(d) of the *Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [as amended].*
    - The investment is made with a body or in an investment scheme described as high quality (see paragraph 33 or with one of the following bodies:
        i. The United Kingdom Government;
        ii. A local authority in England or Wales (as defined in section 23 of *the 2003 Act*) or a similar body in Scotland or Northern Ireland; or
        iii. A parish council or community council.

32. For the purposes of paragraph 32 the Strategy should define high credit quality. Where this definition incorporates ratings provided by credit rating agencies paragraph 42 is relevant.

Loans

33. A local authority may choose to make loans to local enterprises, local charities, wholly owned companies and joint ventures as part of a wider strategy for local economic growth even though those loans may not all be seen as prudent if adopting a narrow definition of prioritising security and liquidity.

34. Local authorities can make such loans whilst continuing to have regard to this guidance if they can demonstrate in their Strategy that:
    - Total financial exposure to these type of loans is proportionate;
    - They have used an allowed “expected credit loss” model for loans and receivables as set out in International Financial Reporting Standard (IFRS) 9 *Financial Instruments* as adopted by proper practices to measure the credit risk of their loan portfolio;
    - They have appropriate credit control arrangements to recover overdue repayments in place; and
    - The local authority has formally agreed the total level of loans by type that it is willing to make and their total loan book is within their self-assessed limit.

Non-specified investments

35. A non-specified investment is any financial investment that is not a loan and does not meet the criteria to be treated as a specified investment.

36. For non-specified investments (i.e. those not meeting the criteria in paragraph 31), the Strategy should:
    - Set out procedures for determining which categories of investments may be prudently used (and where these procedures involve the use of credit ratings, paragraph 32 is relevant).
    - Identify which categories of investments have been defined as suitable for use.
    - State the upper limits for the maximum amounts both individually and cumulatively that may be held in each identified category and for the overall amount held in non-specified investments and confirm that investments made have remained within those limits.

<u>Non-financial investments</u>

37. As defined in paragraph 4 of this guidance non-financial investments are non-financial assets that the organisation holds primarily or partially to generate a profit. Where a local authority holds a non-financial investment, it will normally have a physical asset that can be realised to recoup the capital invested. Local authorities should consider whether the asset retains sufficient value to provide security of investment using the fair value model in *International Accounting Standard 40: Investment Property* as adapted by proper practices.

38. Where the fair value of non-financial investments is sufficient to provide security against loss, the Strategy should include a statement that a fair value assessment has been made within the past twelve months, and that the underlying assets provide security for capital investment.

39. Where the fair value of non-financial investments is no longer sufficient to provide security against loss, the Strategy should provide detail of the mitigating actions that the local authority is taking or proposes to take to protect the capital invested.

40. Where a local authority recognises a loss in the fair value of a non-financial investment as part of the year end accounts preparation and audit process, an updated Strategy should be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

<u>Risk Assessment</u>

41. The Strategy should state the local authority’s approach to assessing risk of loss before entering into and whilst holding an investment, making clear in particular:

- How it has assessed the market that it is/will be competing in, the nature and level of competition, how it thinks that the market/customer needs will evolve over time, barriers to entry and exit and any ongoing investment requirements.
- Whether and, if so how, a local authority uses external advisors be they treasury management advisors, property investment advisors or any other relevant persons.
- How the local authority monitors and maintains the quality of advice provided by external advisors.
- To what extent, if at all, any risk assessment is based on credit ratings issued by credit ratings agencies.
- Where credit ratings are used, how frequently they are monitored and the procedures for taking action if credit ratings change.
- What other sources of information are used to assess and monitor risk.

Liquidity

42. For financial investments that are not treasury management investments or loans the Strategy should set out the procedures for determining the maximum periods for which funds may prudently be committed and state what those maximum periods are and how the local authority will stay within its stated investment limits.

43. For non-financial investments the Strategy should set out the procedures for ensuring that the funds can be accessed when they are needed, for example to repay capital borrowed. It should also state the local authority's view of the liquidity of the investments that it holds, recognising that assets can take a considerable period to sell in certain market conditions. Where local authorities hold non-financial investment portfolios they can choose to assess liquidity by class of asset or at a portfolio level if appropriate.

Proportionality

44. Where a local authority is or plans to become dependent on profit generating investment activity to achieve a balanced revenue budget, the Strategy should detail the extent to which funding expenditure to meet the service delivery objectives and/or place making role of that local authority is dependent on achieving the expected net profit. In addition, the Strategy should detail the local authority's contingency plans should it fail to achieve the expected net profit.

45. The assessment of dependence on profit generating investments and borrowing capacity allocated to funding these should be disclosed as a minimum over the life-cycle of the Medium Term Financial Plan. However, an assessment of longer term risks and opportunities is recommended.

Borrowing in advance of need

46. Authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed.

47. Where a local authority chooses to disregard the Prudential Code and this Guidance and borrows or has borrowed purely to profit from the investment of the extra sums borrowed the Strategy should explain:
    - Why the local authority has decided not to have regard to this Guidance or to the Prudential Code in this instance; and
    - The local authority's policies in investing the money borrowed, including management of the risks, for example, of not achieving the desired profit or borrowing costs increasing.

Capacity, skills and culture

48. The Strategy should disclose the steps taken to ensure that those elected members and statutory officers involved in the investments decision making process have appropriate capacity, skills and information to enable them to take informed decisions as to whether to enter into a specific investment, to assess individual assessments in the context of the strategic objectives and risk profile of the local authority and to enable them to understand how the quantum of these decisions have changed the overall risk exposure of the local authority.

49. The Strategy should disclose the steps taken to ensure that those negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.

50. Where appropriate the Strategy should comment on the corporate governance arrangements that have been put in place to ensure accountability, responsibility and authority for decision making on investment activities within the context of the local authority's corporate values.

ANNEX A – INFORMAL COMMENTARY ON THE STATUTORY GUIDANCE ON LOCAL GOVERNMENT INVESTMENTS

Power under which this Guidance is issued [paragraph 1]

1. The **Local Government Act 2003**, section 15(1), requires a local authority "…to have regard (a) to such guidance as the Secretary of State may issue, and (b) to such other guidance as the Secretary of State may by regulations specify…".

2. The guidance on investments in the main part of this document is issued under section 15(1) of the 2003 Act and authorities are therefore required to have regard to it. This part (**Annex A**) contains an informal commentary ("the commentary") on the Statutory Guidance.

3. Two codes of practice issued by the *Chartered Institute of Public Finance and Accountancy* (CIPFA) contain investment guidance which complements the MHCLG guidance. These publications are:
   - *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes*
   - *The Prudential Code for Capital Finance in Local Authorities*

4. Local authorities are required to have regard to the current editions of the CIPFA codes by regulations 2 and 24 of the *Local Authorities* (*Capital Finance and Accounting) (England) Regulations 2003 [SI 3146] as amended.*

Objectives in updating the Guidance

5. The 2nd edition of this Guidance, which was issued in 2010, reflected concerns raised by the CLG and Treasury Select committees as part of their enquiries into the financial crash of 2007-8. The key areas of focus were:
   - The practice of investing for yield, especially in Icelandic Banks;
   - The need for transparent investment strategies; and
   - The use of Treasury Management advisors.

6. The changes made to the 3rd edition of this Guidance reflect changes in patterns of local authority behaviour. Some local authorities are investing in non-financial assets, with the primary aim of generating profit. Others are entering into very long term investments or providing loans to local enterprises or third sector entities as part of regeneration or economic growth projects that are in line with their wider role for regeneration and place making.

7. In addition, the National Audit Office and the Public Accounts Committee have raised a number of concerns about local authority behaviour that this guidance aims to address. These are:

- Local authorities are exposing themselves to too much financial risk through borrowing and investment decisions;
- There is not enough transparency to understand the exposure that local authorities have as a result of borrowing and investment decisions; and
- Members do not always have sufficient expertise to understand the complex transactions that they have ultimate responsibility for approving.

Effective Date [paragraphs 11-12]

8. This Guidance applies from 1 April 2018. It supersedes all previous editions of the Guidance.

9. The Guidance requires local authorities to produce a number of additional disclosures. Many local authorities already produce these as part of internal reporting and risk management procedures. However, if these disclosures are not currently produced, then local authorities do not need to prepare them in full for Strategies presented to full Council or equivalent before 1 April 2018. Those local authorities who do not include the required disclosures in their 2018-19 strategies, should present them for approval the first time the relevant Strategy is updated or superseded.

Local Authorities [paragraphs 12-13]

10. This Guidance applies to all local authorities, who hold or during the next financial year intend to hold financial or non-financial investments, solely or in part to generate revenue income.

11. It applies to parish councils whose investments exceed the thresholds set out in paragraph 14. The decision to lower the financial threshold for parish councils has been taken in recognition that some parishes have begun to engage in commercial ventures. As parish councils tend to be fairly small and to obtain a greater percentage of their funding directly from council tax payers than other types of local authority, it is right that they demonstrate that they have carefully considered the expertise that they need to manage the risks arising from their strategy.

Transparency and democratic accountability [paragraphs 15-19]

12. The Government believes that local authorities need to be better at explaining "why" not just "what" they are doing with their investment activity. That means that the sector needs to demonstrate more transparency and openness and to

make it easier for informed observers to understand how good governance and democratic accountability have been exercised.

13. The additional disclosures required by the Guidance should be included in a single document presented to full Council or the equivalent. Although the Guidance refers to an Investment Strategy, providing that all of the disclosures are easy for interested parties to find and are in or linked from a single document, a separate Strategy does not need to be prepared. The Strategy should be updated at least annually.

14. Subject to the provisions in paragraph 35 and 36 of the commentary, local authorities can exclude specific non-financial investments from the required disclosures on grounds of commercial confidentiality. The Government expects that non-disclosure on grounds of commercial confidentiality will be an exceptional circumstance. A local authority should only determine that it would breach commercial confidentiality to include an investment in the disclosures on receipt of appropriate professional advice, using the same criteria as would be used to exclude the public from a Council meeting. Local authorities should reassess whether the commercial confidentiality test is met every time a new Strategy is presented to full Council or the equivalent.

15. Under Regulation 17 of the *The Local Authorities (Executive Arrangements) (Meetings and Access to Information) (England) Regulations 2012* as amended overview and scrutiny committee members have right of access to any confidential information relating to any decision by any committee or any member of the executive of their council. Nothing in this Guidance has the power to override this regulation.

16. Assets that generate revenue income solely through fees and charges for discretionary services levied under Section 93 of the *Local Government Act 2003* should not be classified as non-financial investments for this purpose.

17. If disclosures are already produced in another document that is publicly available then a local authority can provide a link to the disclosures from the Strategy rather than reproducing them. The exception is disclosures contained in the Statutory Accounts, which do not meet the requirements of this Strategy. This is because local authority statutory accounts can be complex and difficult for users who are not familiar with local government accounting to understand and statutory accounts are prepared to a higher level of materiality than local authorities should use for internal risk management.

<u>Contribution [paragraphs 20-22]</u>

18. Local authorities may have several different objectives, when deciding to acquire an asset. If an asset is not solely held for yield, then a local authority may have a different risk appetite or be willing to accept a lower return than it otherwise would.

19. Each local authority should determine how it categorises different types of contribution, and each investment can have more than one type of contribution. A non-exhaustive list of types of contribution include:
    - Yield/profit
    - Regeneration
    - Economic benefit/business rates growth
    - Responding to local market failure
    - Treasury management

20. Where a local authority classifies an investment as contributing to regeneration or local economic benefit, it should be able to demonstrate that the investment forms part of a project in its Local Plan.

<u>Use of indicators [paragraphs 23-25]</u>

21. Local authorities should present a range of indicators to allow members and other interested parties to understand the total exposure from borrowing and investment decisions. The indicators should cover both the local authority's current position and the expected position assuming all planned investments for the following year are completed. The indicators do not need to take account of Treasury Management investments unless these are expected to be held for more than 12 months.

22. The Guidance requires local authorities to develop quantitative indicators that allow Councillors and the public to assess a local authority's total risk exposure as a result of its investment decisions. We recommend that, the indicators in the table below are used. Where local authorities have a different risk appetite or different expectation of returns depending on the contribution(s) each type of investment makes, they should consider presenting the indicators, classified by type of contribution or risk appetite.

Debt to net service expenditure (NSE) ratio	*Gross debt as a percentage of net service expenditure, where net service expenditure is a proxy for the size and financial strength of a local authority.*
Commercial income to NSE ratio	*Dependence on non-fees and charges income to deliver core services. Fees and charges should be netted off gross service expenditure to calculate NSE.*
Investment cover ratio	*The total net income from property investments, compared to the interest expense.*
Loan to value ratio	*The amount of debt compared to the total asset value.*
Target income returns	*Net revenue income compared to equity. This is a measure of achievement of the portfolio of properties.*
Benchmarking of returns	*As a measure against other investments and against other council's property portfolios.*
Gross and net income	*The income received from the investment portfolio at a gross level and net level (less costs) over time.*
Operating costs	*The trend in operating costs of the non-financial investment portfolio over time, as the portfolio of non-financial investments expands.*
Vacancy levels and Tenant exposures for non-financial investments	*Monitoring vacancy levels (voids) ensure the property portfolio is being managed (including marketing and tenant relations) to ensure the portfolio is productive as possible.*

23. Where appropriate, local authorities should consider including targets or limits set by members alongside the outturn. Where there has been a significant change in year on year performance against any of the indicators presented local authorities should include an explanation in the Strategy.

24. Local authorities can choose to present additional indicators in the Strategy should they believe that it would enhance understandability and transparency to do so.

<u>Security, liquidity and yield [paragraphs 26-29]</u>

25. For treasury management and other financial investments local authorities should continue to prioritise **SECURITY, LIQUIDITY** and **YIELD** in that order of importance.

26. Whilst consideration of **security** and **liquidity** is important for loans and non-financial investments, the relative balance between objectives may be different depending on the nature and objectives in making a specific investment.

Security and liquidity

Loans [paragraphs 33 – 34, 40]

27. Loans to joint ventures, local SMEs or third sector bodies, and wholly owned companies fall within the scope of the Guidance. When considering security and liquidity of loans local authorities should set limits for their total exposure and apply the expected loss model in line with the requirements of *IFRS 9 Financial Instruments*.

Non-financial investments [paragraphs 37-40, 43]

28. Where a local authority has a non-financial investment, it will have an asset that can be realised to recoup the sums invested. Therefore, the Guidance requires local authorities to consider security by reference to the value of the asset relative to purchase price and to set out the plans to recoup the investment if realising the asset would not recoup the sums invested. In the period immediately after purchase, it is normal for the directly attributable costs of purchasing an non-financial investment to be greater than the realisable value of the asset. In this scenario, all the Strategy needs to disclose is how long the local authority expects it to take for the increase in asset values to provide security for the sums invested and the assumptions underpinning that expectation.

29. Non-financial investments are by their nature illiquid. However, this does not mean that the local authority does not need to plan for realising a part of its non-financial investment portfolio, for example to repay debt. The liquidity of the non-financial investment portfolio should be considered over the repayment period of any debt taken out to acquire assets, which could be very long term. Given current trends such as the scale and pace of technology driven change, there is no guarantee that non-financial investments will continue to deliver value over their lifetime. To manage this risk, local authorities need to have plans to realise the capital tied up in non-financial investments if required. In addition, the Strategy should consider the trade-offs between accepting capital loss and refinancing debt incurring additional debt servicing costs by doing so, if appropriate.

Proportionality [paragraphs 44-45]

30. Local authorities need to consider the long term sustainability risk implicit in becoming too dependent on commercial income or in taking out too much debt relative to net service expenditure.

31. In addition, whilst under statute, local authority debt is secured on the revenues of that authority, in practice, there is no realistic prospect of the revenues of any local authority being sufficient to pay back debt equating to many multiples of the sum of NNDR and Council Tax Income, without a pervasive and long term impact on service delivery. It is unclear whether local authorities who have adopted a debt financed commercial investment strategy have realistic plans to manage failure. Whilst the Government recognises the importance of local authorities taking on debt to enhance service provision, irrespective of the source of finance, it does not believe that it should do the same for commercial investments.

32. For this reason, the Guidance introduces a new requirement that in every local authority, full council or its nearest equivalent, sets limits that cannot be exceeded for gross debt compared to net service expenditure, and for commercial income as a percentage of net service expenditure.

33. If a local authority has exceeded these limits through investments taken out prior to the introduction of this Guidance, it does not need to dispose of investments currently held. However, authorities who have exceeded their self-assessed limits should not enter into any further investments, irrespective of how these are financed, other than short term investments required for efficient treasury management.

<u>Borrowing in advance of need [paragraphs 46-47]</u>

34. The Prudential Code, issued by CIPFA has always contained a statement that local authorities should not borrow more than, or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The purpose of repeating that statement in this Guidance is to make it clear that it extends to borrowing taken on to finance the acquisition of non-financial as well as financial investments.

35. Local authorities can still finance the acquisition of financial on non financial investments from capital receipts generated from the sale of surplus assets. However, they should not repurpose receipts allocated to the acquisition of assets that contribute to service delivery to fund the purchase of investments, solely to avoid the requirements against borrowing in advance of need.

36. If exceptionally a local authority, chooses not to have regard to the provision on borrowing to fund investment activity the Guidance requires them to explain, in their Strategy, the rationale for this decision.

37. The purpose of this disclosure is to allow external auditors, tax payers and other interested parties to understand why the local authority has chosen to disregard

the Guidance, and to hold the authority to account should they believe there is not sufficient reason for doing so.

Capacity, Skills and Culture [paragraphs 48-50]

38. In the Public Accounts Committee report of 18 November 2016[1], members raised concerns that, locally elected members may not always have the background and expertise to understand the risks associated with the decisions that they are being asked to make. For this reason the Guidance extends the requirements on capacity and skills to members and any statutory officers involved in or responsible for signing off on investment decisions.

39. Members do not necessarily need formal training in understanding investment risks to satisfy the requirements of the Guidance. Depending on their level of expertise a presentation setting out the risks and opportunities of an investment strategy/specific investment in terms a layman would understand, may be sufficient to meet the new requirements.

40. The Government is aware that many local authorities have brought in outside expertise to identify and negotiate investment opportunities. Whilst this can be an effective method of risk management, it is important that those negotiating deals understand that they are not operating in a purely commercial environment and that the prime purpose of a local authority is to deliver statutory services to local residents. Therefore, the Strategy should comment on how they have been made aware of this.

[1] https://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/inquiries/parliament-2015/financial-sustainability-local-authorities-16-17/

STATUTORY GUIDANCE ON MINIMUM REVENUE PROVISION

Guidance issued by the Secretary of State under section 21(1A) of the *Local Government Act 2003*

POWER UNDER WHICH THE GUIDANCE IS ISSUED

1. The following Guidance is issued by the Secretary of State under section 21(1A) of the *Local Government Act 2003.* Under that section local authorities are required to “have regard” to this guidance.

DEFINITION OF TERMS

2. The **2003 Act** means the *Local Government Act 2003.*

3. The **2007 Act** means the *Local Government and Public Involvement in Health Act 2007.*

4. The **2003 Regulations** means the L*ocal Authorities (Capital Finance and Accounting) (England) Regulations 2003* [as amended].

5. **Local authority** has the meaning given in section 23 of the 2003 Act.

6. **MRP** means Minimum Revenue Provision.

7. The **Prudential Code** means the statutory code of practice, issued by CIPFA, referred to in Regulation 2 of the 2003 Regulations.

8. **CFR** means the Capital Financing Requirement, as defined in the Prudential Code.

9. **Non-housing CFR** has the meaning given in Regulation 28(11) of the 2003 Regulations, before this was amended. This is the total CFR for a local authority less the Housing Revenue Account CFR, where a local authority has a Housing Revenue Account.

10. **Credit Arrangement** has the meaning given in Section 7 of the 2003 Act.

11. **Supported Capital Expenditure** means the total amount of capital expenditure which a local authority had been notified by one or more Government departments was to be taken into account in the calculation of the revenue grant due to the local authority in respect of it its use of borrowing and credit. It excludes any expenditure that is supported by capital grant.

12. **Housing assets** means any land, dwellings or other property to which Section 74(1) of the Local Government Housing Act 1989 (duty to keep a Housing Revenue Account) applies.

13. **UL** means the estimated useful life of an asset as determined by proper accounting practices.

14. **Lease** means a lease transaction as defined under proper accounting practices.

APPLICATION

Effective date

15. This Guidance applies for accounting periods starting on or after 1 April 2019, with the exception of paragraphs 27-29 of this Guidance "Changing Methods for Calculating MRP", which apply from accounting periods starting on or after 1 April 2018. However, early adoption is encouraged. It supersedes all previous versions of this Guidance.

Local authorities

16. This guidance applies to all local authorities in England and their relevant bodies. It does not apply to parish councils or charter trustees.

INTRODUCTION

17. Under Regulation 27 of the 2003 Regulations, local authorities are required to charge MRP to their revenue account in each financial year. Before 2008, the 2003 Regulations contained details of the method that local authorities were required to use when calculating MRP. This has been replaced by the current Regulation 28 of the 2003 Regulations, which gives local authorities flexibility in how they calculate MRP, providing the calculation is 'prudent'. In calculating a prudent provision, local authorities are required to have regard to this guidance.

ANNUAL MRP STATEMENT

18. Before the start of each financial year a local authority should prepare a statement of its policy on making MRP in respect of that financial year and submit it to full Council for approval. For local authorities without a full Council the statement should be presented for approval at the closest equivalent level. The statement should describe how it is proposed to discharge the duty to make prudent MRP during that year.

19. Local authorities can vary the methodologies that they use to make prudent provision during the year. If they do so they should present a revised MRP statement to the next full Council or equivalent. Where a change in MRP

methodology would impact on the value for money assessment of non-financial investments, the updated statement should summarise this impact.

MEANING OF PRUDENT PROVISION

20. Regulation 28 of the 2003 Regulations requires a local authority to calculate in each financial year an amount of MRP that it considers to be prudent.

21. An underpinning principle of the local authority financial system is that all capital expenditure has to be financed either from capital receipts, capital grants (or other contributions) or eventually from revenue income. The broad aim of prudent provision is to require local authorities to put aside revenue over time to cover their CFR. In doing so, local authorities should align the period over which they charge MRP to one that is commensurate with the period over which their capital expenditure provides benefits.

22. In the case of historical borrowing originally supported by grant income rolled into Revenue Support Grant the meaning of prudent provision is to put funds aside over a period commensurate with the period implicit in the determination of that original grant.

23. The Secretary of State considers that the methods of making prudent provision include the options set out in paragraphs 31 to 37. However, this does not rule out or otherwise preclude a local authority from using an alternative method should it decide that is more appropriate. Any method used is subject to the conditions in paragraphs 38 to 42 as far as these are relevant.

OVERPAYMENTS OF MRP

24. Local authorities may choose to pay more MRP than they consider prudent in any given year. If they do so they should separately disclose the in-year and cumulative amount of MRP overpaid in the Statement presented to full council

MEANING OF CHARGE TO A REVENUE ACCOUNT

25. A charge to a revenue account for MRP cannot be a negative charge.

26. A charge to a revenue account for MRP can only be £nil if:
    - A local authority's CFR was nil or negative on the last day of the preceding financial year; or
    - A local authority chooses to offset a previous year's overpayment (as set out in paragraph 24) against the current year's prudent provision. If a local authority chooses to offset a previous year's overpayment, they should disclose this fact and any remaining cumulative overpayment of MRP in the Statement presented to full council.

CHANGING METHODS FOR CALCULATING MRP

27. A local authority may change the method(s) that it uses for calculating part or all of its MRP at any time.

28. Where a local authority changes the method(s) that it uses to calculate MRP, it should explain in its Statement, why the change will better allow it to make prudent provision.

29. The calculation of MRP under the new method(s) should be based on the residual CFR at the point the change in method is made (i.e. it should not be applied retrospectively). Changing the method used to calculate MRP can never give rise to an overpayment in respect of previous years, and should not result in a local authority making a reduced charge or a charge of £nil for the accounting period in which the change is made, or in any subsequent period, on the grounds that it needs to recover overpayments of MRP relating to previous years.

TRANSFERRING DEBT

30. Where debt is transferred between authorities, the authorities concerned should agree on the arrangements for the continued making of MRP and adjust their unfunded CFRs accordingly. Normally the authority releasing the debt should cease to make MRP in respect of it and the authority taking it over should begin to make MRP in the same way that it would do for any other increase in CFR.

OPTIONS FOR MAKING PRUDENT PROVISION

31. This Guidance presents four ready-made options for calculating prudent provision. Local authorities can use a mix of these options for debt taken out at different times should they consider it appropriate to do so.

<u>Option 1: Regulatory method</u>

32. MRP is equal to the amount determined in accordance with the former Regulations 28 and 29 of the 2003 Regulations as if they had not been revoked by the 2008 amendment to those regulations. For the purposes of that calculation, the adjustment A should normally continue to have the value attributed to it by the local authority in the financial year 2004-05. However, it would be reasonable for local authorities to correct any perceived errors in adjustment A, if the correction would be in their favour.

33. The former Regulations 28 and 29 of the 2003 Regulations are included at **Annex A**.

Option 2: CFR method

34. MRP is equal to 4% of the non-housing CFR at the end of the preceding financial year.

Option 3: Asset Life Method

35. Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be determined by reference to the useful life of the asset. There are two main methods by which this can be achieved, as described below.

(a) Equal instalment method

MRP is the amount given by the following formula:

$$\frac{A - B}{C}$$

Where:

A is the amount of capital expenditure in respect of the asset financed by borrowing or credit arrangements.

B is the total provision made before the current financial year in respect of that expenditure.

C is the inclusive number of financial years from the current year to that in which the estimated useful life of the asset expires.

(b) Annuity method

MRP is the principal element for the year of the annuity required to repay over the asset's useful life the amount of capital expenditure financed by borrowing or credit arrangements. The authority should use an appropriate interest rate to calculate the amount. Adjustments to the calculation to take account of repayment by other methods during repayment period (e.g. by the application of capital receipts) should be made as necessary.

Option 4: Depreciation method

36. MRP is deemed to be equal to the provision required in accordance with deprecation accounting in respect of the asset on which expenditure has been financed by borrowing or credit arrangements. This should include any amount for impairment charged to the income and expenditure accounts.

37. For this purpose standard depreciation accounting procedures should be followed, except in the following respects:

- MRP should continue to be made annually until the cumulative amount of provision made is equal to the expenditure originally financed by borrowing or credit arrangements. Thereafter the authority will cease to make MRP.
- On disposal of the asset, the charge should continue in accordance with the depreciation schedule as if the disposal had not taken place. This does not affect the ability to apply capital receipts or other funding sources at any time to repay all or part of the outstanding debt.

Where the percentage of the expenditure on the asset financed by borrowing or credit arrangements is less than 100%, MRP should be equal to the same percentage of the provision required under depreciation accounting.

CONDITIONS FOR USING THE OPTIONS

38. **Use of options.** Options 1 and 2 may only be used in relation to capital expenditure incurred before 1 April 2008, which form part of its supported capital expenditure.

39. For expenditure incurred on or after 1 April 2008, which does not form part of the authority's supported capital expenditure, prudent approaches include options 3 and 4.

40. **Commencement of provision.** Subject to paragraph 41 below, MRP should normally commence in the financial year following the one in which the expenditure was incurred.

41. **MRP Commencement.** When borrowing to provide an asset, the authority may treat the asset life as commencing in the year in which the asset first becomes operational. Therefore, it may postpone beginning to make MRP until the financial year following the one in which the asset becomes operational. 'Operational' here means when an asset transfers from Assets under Construction to an Assets in Use category under normal accounting rules.

42. Estimated useful life of assets. Where a local authority uses options 3 or 4 or where it uses another methodology that has the UL of assets as a component to the calculation, it should normally not exceed a maximum UL of 50 years. Local authorities can exceed this maximum in two scenarios:
   - where a local authority has an opinion from an appropriately qualified professional advisor that an asset will deliver service functionality for more than 50 years it can use the life suggested by its professional advisor; and
   - for a lease or PFI asset, where the length of the lease/PFI contract exceeds 50 years. In this case the length of the lease/PFI contract should be used.

LEASES AND PFI

43. In the case of finance leases (or, when applicable, leases where a right-of-use asset is on balance sheet) and on balance sheet PFI contracts, the MRP requirement would be regarded as met by a charge equal to the element of the rent/charge that goes to write down the balance sheet liability. Where a lease (or part of a lease) or PFI contract is brought onto the balance sheet, having previously been accounted for off- balance sheet, the MRP requirement would be regarded as having been met by the inclusion in the charge for the year in which the restatement occurs, of an amount equal to the write-down for that year plus retrospective writing down of the balance sheet liability that arises from the restatement.

HOUSING ASSETS

44. The duty to make MRP does not extend to cover borrowing or credit arrangements used to finance capital expenditure on housing assets (as defined in paragraph 12 above).

INVESTMENT PROPERTIES

45. The duty to make MRP extends to investment properties where their acquisition has been partially or fully funded by an increase in borrowing or credit arrangements. As depreciation is not charged on investment properties, Option 4: the Depreciation method is not a suitable approach for calculating the MRP to be charged in respect of investment properties.

CAPITALISED EXPENDITURE

46. Where on or after 1 April 2008 an authority incurs expenditure which is:
    - Financed by borrowing and credit arrangements; and
    - Treated as capital expenditure by virtue of either a direction under section 16(2)(b) of the 2003 Act or Regulation 25(1) of the 2003 Regulations,

    The authority should calculate MRP in accordance with Option 3.

47. For the purpose of the formula in paragraph 35 above, in the initial year of making MRP the variable "C" should be given the maximum values as set out in the following table:

Expenditure type	**Maximum value of "C" in initial year**
Expenditure capitalised by virtue of a **direction under s.16(2)(b)**	"C" equals 20 years
Regulation 25(1)(a) Expenditure on computer programmes	"C" equals the shorter of the UL of the hardware or the length of the software license.
Regulation 25(1)(b) Loans and grants towards capital	"C" equals the UL of the assets for in relation to which the third party

expenditure by third parties.	expenditure is incurred.
Regulation 25(1)(c) Repayment of grants and loans for capital expenditure	“C” equals 25 years or the period of the loan if longer.
Regulation 25(1)(d) Acquisition of share capital	“C” equals 20 years.
Regulation 25(1)(e) Expenditure on works to assets not owned by the authority	“C” equals the UL of the assets.
Regulation 25(1)(ea) Expenditure on assets for use by others.	“C” equals the UL of the assets.
Regulation 25(1)(f) Payment of levy on large scale voluntary transfers (LSVT) of dwellings	“C” equals 25 years.

ANNEX A – REGULATIONS 28 AND 29 OF THE 2003 REGULATIONS BEFORE THESE WERE AMENDED

Calculation of minimum revenue provision

28.—(1) Subject to paragraphs (2) and (3) and regulation 29, the minimum revenue provision for the current financial year shall be calculated by the local authority in accordance with the following formula—

$$\frac{4[CFR \quad (A - HC)]}{100}$$

where—

- CFR is the capital financing requirement at the end of the preceding financial year;
- A is an adjustment (which may be a positive, nil or negative amount) to be calculated in accordance with the following formula—

$$[CFRM - (HA + NHA)] + \frac{(HA - HB)}{2}$$

where—

  - CFRM is the capital financing requirement on 31st March 2004;
  - HA is the housing amount on 31st March 2004;
  - HB is the opening HRA capital financing requirement for the financial year beginning on 1st April 2004, except that if that opening HRA capital financing requirement is a negative amount, HB is nil; and
- NHA is the non-housing amount on 31st March 2004; and
- HC is the opening HRA capital financing requirement for the current financial year, except that if that opening HRA capital financing requirement is a negative amount, HC is nil.

(2) An additional amount of minimum revenue provision for the current financial year ("the additional amount") shall be calculated by the local authority where—

(a)a credit approval, within the meaning of regulation 136 of the Local Authorities (Capital Finance) Regulations 1997 (use of certain credit approvals)(1), was issued to the local authority before 1st April 2004; and

(b)the amortisation period specified in the credit approval expires during or after the current financial year,

and the additional amount shall be the total amount determined by the local authority under regulation 136(2) of those Regulations for the current financial year, as if those Regulations were still in force for the purposes of this regulation.

(3) Where, in relation to the current financial year, the total of—

(a)the amount calculated in accordance with the formula for the minimum revenue provision in paragraph (1); and (b)the additional amount, if any, calculated under paragraph (2),

is a negative amount, the minimum revenue provision for the current financial year shall be treated as nil.

(4) For the purposes of this regulation—

"arms length management organisation" means a body set up by a local authority as a housing management company to exercise management functions as agent of the local authority under an arrangement approved by the Secretary of State under section 27 of the Housing Act 1985 (management agreements)(2);

"capital financing requirement" has the same meaning as in the "Prudential Code for Capital Finance in Local Authorities" published by CIPFA, as amended or reissued from time to time(3);

"certified value" means the market value certified by the district valuer or by a suitably qualified valuer employed by the local authority;

"current financial year" means any financial year for which the local authority is determining the amount of its minimum revenue provision;

"district valuer", in relation to any land in the district of a local authority, means an officer of the Commissioners of Inland Revenue appointed by them for the purpose of exercising, in relation to that district, the functions of the district valuer under the Housing Act 1985;

"housing amount" and "non-housing amount" have the same meaning as those terms had on 31st March 2004 in Part XII of the Local Authorities (Capital Finance) Regulations 1997 (minimum revenue provision);

"Housing Revenue Account", also referred to as "HRA", has the same meaning as in section 74 of the Local Government and Housing Act 1989 (duty to keep Housing Revenue Account)(4);

"major repairs reserve" has the same meaning as in regulation 7(5) of the Accounts and Audit Regulations 2003 (statement of accounts)(5);

"opening HRA capital financing requirement" means—

(a) for the financial year beginning on 1st April 2004, the amount calculated in accordance with paragraph (5);
(b) for the financial year beginning on 1st April 2005 and any subsequent financial year, the amount calculated In accordance with paragraph (6); and

"preceding financial year" means the financial year immediately preceding the current financial year.

(5) The amount referred to in sub-paragraph (a) of the definition of "opening HRA capital financing requirement" in paragraph (4) is the amount calculated in accordance with the following formula—

$$OHCC + IA - ID$$

where—

OHCC is the opening HRA credit ceiling for the financial year beginning on 1st April 2003, which has the same meaning as the "opening HRA credit ceiling" in paragraph 7.1 of the Item 8 Credit and Item 8 Debit (General) Determination 2003-2004 ("the Determination")(6);

IA means the total of—

(a)

the items to be aggregated as specified in paragraph 7.2 of the Determination but substituting "2003-2004" for "2002-2003" in each place where it occurs in that paragraph; and

(b)

the amounts of all supplementary credit approvals issued in respect of financial years beginning before 1st April 2004 under section 54 of the Local Government and Housing Act 1989 (supplementary credit approvals)(7) for the purposes of expenditure in relation to arms length management organisations; and

ID means the items to be deducted as specified in paragraph 7.3 of the Determination but substituting “2003-2004” for “2002-2003” in each place where it occurs in that paragraph.

(6) The amount referred to in sub-paragraph (b) of the definition of “opening HRA capital financing requirement” in paragraph (4) is the amount calculated in accordance with the following formula—

$$OCFR + TIA - TID$$

where—

- OCFR means the opening HRA capital financing requirement for the preceding financial year;
- TIA means the total items to be aggregated, being the total of the following—

(a) the capital expenditure of the local authority financed by borrowing or credit arrangements which was incurred during the preceding financial year on any interest in housing land; and

(b) the certified value of any interest in housing land which commenced or recommenced to be accounted for in the Housing Revenue Account in the preceding financial year for a reason other than acquisition by the local authority;

- TID means the total items to be deducted, being the total of the following—

(a) such part of any capital receipt from the disposal of an interest in housing land which was used during the preceding financial year to repay the principal of any amount borrowed by the local authority or to meet any liability in respect of credit arrangements;

(b) 75 per cent. of the certified value of any interest in a dwelling, and 50 per cent. of the certified value of any interest in other housing land, that ceased to be accounted for in the Housing Revenue Account in the preceding financial year other than by virtue of disposal by the local authority;

(c) the amount of the provision for the repayment of the principal of any amount borrowed by the local authority or the meeting of any liability in respect of credit arrangements which the local authority determined during the preceding financial year to make from the Housing Revenue Account; and

(d) the amount of the provision for the repayment of the principal of any amount borrowed by the local authority or the meeting of any liability in respect of credit arrangements which the local authority determined during the preceding financial year to make from the major repairs reserve.

Commutation adjustment

29.—(1) Subject to paragraph (2), where a commuted payment was made to or for the benefit of a local authority in the financial year beginning on 1st April 1992, the local authority may reduce the amount of its minimum revenue provision for the current financial year, calculated in accordance with regulation 28, by an amount calculated in accordance with the following formula—

$$G \quad (I - M)$$

where—

- G is the total amount of contributions, grants and subsidies which would have been payable to the local authority by the Secretary of State for the current financial year but for commutation;
- I is the total of—

(a) the amount by which interest, payable by the local authority in the current financial year on loans, is reduced; and

(b) the amount by which interest, payable to the local authority in the current financial year on deposits and investments, is increased, by virtue of commutation; and

- M is the amount of minimum revenue provision for the current financial year which would have been calculated by the local authority in accordance with regulation 28 but for commutation, less the amount of minimum revenue provision for the current financial year actually calculated in accordance with regulation 28.

(2) Where the amount calculated in accordance with the formula in paragraph (1) is a negative amount, that amount shall be treated as nil.

(3) For the purposes of paragraph (1)—

"commutation" means the making of a commuted payment to, or for the benefit of, a local authority in the financial year beginning on 1st April 1992;

"commuted payment" has the same meaning as that term had on 31st March 2004 in section 157 of the Local Government and Housing Act 1989 (commutation of, and interest on, periodic payments of grants etc.)(8); and

"current financial year" has the same meaning as in regulation 28(4).

ANNEX B – INFORMAL COMMENTARY ON THE STATUTORY GUIDANCE ON MINIMUM REVENUE PROVISION

Introduction

1. **The main section** of this document contains Statutory Guidance on Minimum Revenue Provision ("the Guidance") issued by the Secretary of State. **Annex A** provides the former Regulations 28 and 29 of the (Capital Finance and Accounting) (England) Regulations 2003. These have now been amended and have no force in statute. However, the calculations in these Regulations are still used for recommended option 1, the CFR method, so the former Regulations have been included as an Annex to this Guidance. **Annex B** provides an informal commentary ("the commentary") on that statutory guidance. **Annex C** provides the transitional arrangements.

2. Local authorities are normally required each year to set aside some of their revenues as provision for debt. More precisely, the provision is in respect of capital expenditure financed by borrowing or credit arrangements but, both in these guidance notes and in the statutory guidance, it has generally proved more convenient to use the term "debt" as shorthand for that technically more accurate form of expression.

Application Date

3. The Guidance and the commentary apply from 1 April 2019. The exception is paragraphs 27-29 of the Guidance and the commentary on those paragraphs, which apply from 1 April 2018. All previous editions of the MRP Guidance and any commentary published with that Guidance are superseded.

4. When considering transitional arrangements local authorities should refer to the Q&A published alongside the consultation, which is reproduced at **Annex C**.

MRP Calculation – Amendment Regulation

5. Amendment regulation 4(1) of the 2008 Regulations revised the former regulation 28. In the new regulation 28, the detailed rules are replaced with a simple duty for an authority each year to make an amount of MRP which it considers to be "prudent". The regulation does not itself define "prudent provision". However, the MRP guidance makes recommendations to authorities on the interpretation of that term. The operative date of the change is 31 March 2008, which means that it applies to the financial year 2007-08 and to subsequent years.

Power to Issue Guidance

6. The issue of statutory MRP guidance was made possible by section 238(2) of the *Local Government and Public Involvement in Health Act 2007*, which amends section 21 of the *Local Government Act 2003*. Section 21 already allowed

regulations to be made on accounting practices and is the power under which the existing MRP regulations were made. The amendment inserts a new section 21(1A) into the 2003 Act, enabling the Secretary of State also to issue *guidance* on accounting practices and thus on MRP.

7. Authorities are obliged by new section 21(1B) to "have regard" to such guidance – which is exactly the same duty as applies to other pieces of statutory guidance including, for example, the CIPFA Prudential Code, the CIPFA Treasury Management Code and the MHCLG Guidance on Local Government Investments.

8. The statutory MRP guidance itself is the front section of the present document. Annex B of this document is an informal commentary, explaining the policy intention in more detail and including other information to help practitioners; it has no statutory force.

9. Specific requirements of the statutory guidance are considered in more detail below.

<u>Annual MRP Statement [paragraphs 18-19 of the guidance]</u>

10. Authorities are asked to prepare an annual statement of their policy on making MRP for submission to their full council (for authorities without a full council, approval of the statement should be at the closest equivalent level). This mirrors the existing requirements to report to the council on the prudential borrowing limit and investment policy. The aim is to give elected Members the opportunity to scrutinise the proposed use of the additional freedoms conferred under the new arrangements. If it is ever proposed to vary the terms of the original statement during the year, a revised statement should be put to the council at that time. It is for each council to consider with its officers the preferred format of the statement and MHCLG will not being issuing any advice on the matter.

11. To underpin this recommendation, it was necessary to amend the *Local Authorities (Functions and Responsibilities) (England) Regulations 2000 [SI 2000/2853].* Regulation 4(1)(b) specifies functions which are not to be the sole responsibility of an authority's executive and includes the authority's borrowing, investments, capital expenditure and now also the making of MRP.

<u>Meaning of prudent provision [paragraphs 20 – 23 of the guidance]</u>

12. The main part of the guidance is concerned with recommendations on the interpretation of the term "prudent provision" as used in the amended Regulation 28. The guidance includes specific examples of options for making "prudent provision".

13. It explains that provision for the debt which financed the acquisition of an asset should be made over a period bearing some relation to that over which the asset continues to provide a service. However, some local authorities have increased their debt to acquire assets that do not generate direct service benefits, for example assets held for investment purposes or as part of regeneration schemes. In addition, there may be a significant mismatch between the period over which an asset provides a direct service benefit and the lifetime of the debt that has been taken out to acquire assets taken out.

14. Whilst recognising that local authorities have options other than building up prudent provision to repay debt, the Government has identified that there is a mismatch between the weighted average lifetime of local authority debt and the length of time it would take to fully provide for that debt based on current levels of MRP charged. Whilst this is not a risk if ease of access to PWLB remains unchanged, assuming that this will remain the case over the length of longer dated local authority debt instruments is not a prudent approach. For this reason, the Government has changed the definition of "prudent provision" to highlight that there is a balance between matching MRP to the service potential of assets and to the weighted average lifetime of local authority debt.

<u>Meaning of a charge to a revenue account [paragraphs 25-26]</u>

15. The Government has identified that there are some local authorities who have adopted very aggressive strategies with regard to making provision for repayment of debt. In some cases these have resulted in charges of £nil or negative charges being made. Feedback from external auditors indicates a lack of understanding about whether such practices are lawful.

16. The Government is of the view that this is not the most prudent approach that local authorities could adopt, and those that do so are deferring cost so that it falls on future rather than current council tax payers. Therefore, this update clarifies that except in cases where a local authority has a negative or nil CFR or is offsetting a previous overpayment of MRP, MRP should not be £nil or a negative charge.

<u>Negative CFR</u>

17. Where the CFR (as calculated for the normal purposes of the Prudential Code and not the adjusted CFR mentioned above) is nil or negative on the last day of a financial year, this indicates that the authority's provision for debt is equal to or greater than the debt incurred. There is accordingly no need to make MRP in the following financial year under any of the specified options, or in any other way.

Change in methods for calculating MRP [paragraphs 27 – 29]

18. The most common justification for local authorities who have decided to significantly reduce their MRP charge or take a payment holiday is that a changing the methodology that they use to calculate MRP has resulted in identification of a historical overpayment. The mechanism tends to be a reassessment of the assumptions underpinning Option 3: The Asset Life Method.

19. Given that conceptually, this recommended option requires local authorities to charge MRP as a proxy for depreciation, and depreciation is an accounting estimate, the Government believes that local authorities should follow proper accounting practices when changing an accounting estimate. In depreciation accounting, when an entity reassesses the life of an asset, it does not recalculate the depreciation it has charged from acquisition of the asset. Instead, depreciation must be recalculated over the revised asset life using the current net book value of the asset as the new starting point.

20. Adopting this approach will require local authorities to spread the benefit of charging a lower annual MRP to council tax payers over time, rather than taking all of the benefits up front at the expense of longer term financial sustainability.

OPTIONS FOR PRUDENT PROVISION

21. Four ready-made options are included in the guidance (and there are two alternatives under Option 3). The options are those likely to be most relevant for the majority of authorities but other approaches are not meant to be ruled out, provided that they are fully consistent with the statutory duty to make prudent revenue provision. Authorities must always have regard to the guidance, but having done so, may in some cases consider that a more individually designed MRP approach is justified. That could involve taking account of detailed local circumstances, including specific project timetables and revenue-earning profiles. Authorities may wish to consult their legal advisers and external auditors about their approach to MRP if it involves a significant departure from the guidance or relates to any large, complex or novel schemes. However, the decision on what is prudent is for the authority and it is not for MHCLG to say in particular cases whether any proposed arrangement is consistent with the statutory duty.

Option 1: Regulatory Method [paragraphs 32 - 33]

22. For debt which is supported by the Government through the RSG system, authorities may continue to use the formulae in the current regulations, since the RSG is calculated on that basis. Although the existing regulation 28 is revoked by regulation 4(1) of the 2008 Regulations, authorities will be able to calculate MRP as if it were still in force. The earlier regulations relevant to MRP are included in this Guidance at **Annex A**.

23. Normally, under this option, the former regulations should be followed exactly as if they had not been revoked. That includes taking advantage, if desired, of the **commutation adjustment** in the former regulation 29.

24. When introducing the new MRP regime in 2004, as part of the Prudential system framework, the Government's policy aim was that the move from the former MRP scheme should not itself increase any authority's MRP liability. Safeguards to achieve that result were built in from the outset (or added later as anomalies came to light).

25. The main device for achieving the neutrality between old and new MRP systems was "Adjustment A" in the original regulation 28. This was an amount to be calculated at the start of the new system in 2004 and not subsequently varied. For the purposes of Option 1, Adjustment A should therefore continue to be given the value attributed to it in the financial year 2004-05, even if that value reflected erroneous calculations under the former capital finance system which reduce MRP liability under the present system. If, however, Adjustment A reflects an error which increases the current MRP liability, the authority would be justified in recalculating it and hence reducing MRP to its proper level.

26. Similarly, if an authority considers that, in its particular circumstances, strict compliance with any other aspect of the former regulations would produce an anomalous and disadvantageous result, it may consider modifying the rules to achieve the intended neutrality. Again, such a step should be discussed in advance with external auditors.

<u>Option 2: CFR Method [paragraph 34]</u>

27. This is a technically much simpler alternative to Option 1 which may be used in relation to supported debt. While still based on the concept of the Capital Financing Requirement [CFR], which is easily derived from the balance sheet, it avoids the complexities of the formulae in the old regulation 28 (though for most authorities it will probably result in a higher level of provision than Option 1). It does however still rely on definitions in regulation 28(11), which are as follows:

"Non-housing CFR" means that part of the capital financing requirement which is not housing CFR. "Housing CFR" means that part, if any, of the capital financing requirement which is in respect of borrowing or credit arrangements used to finance capital expenditure on housing assets. "Housing assets" means any land, houses or other property to which subsection (1) of section 74 of the Local Government and Housing Act 1989 (duty to keep Housing Revenue Account) for the time being applies.

<u>Option 3: Asset Life Method [paragraph 35]</u>

28. For new borrowing under the Prudential system for which no Government support is being given and is therefore self-financed, there are two options included in the guidance.

29. Option 3 is to make provision over the estimated life of the asset for which the borrowing is undertaken. This is a possibly simpler alternative to the use of depreciation accounting (Option 4), though it has some similarities to that approach. Within option 3, two methods are identified.

30. The first of these, the **equal instalment method**, allows the use of the simple formula in paragraph 35(a) of the guidance. This will normally generate a series of equal annual amounts over the estimated life of the asset. The original amount of expenditure ("A" in the formula) remains constant. The cumulative total of the MRP made to date ("B" in the formula) will increase each year.

31. The outstanding period of the **estimated life** of the asset ("C" in the formula) reduces by 1 each year. For example, if the life of the asset is originally estimated at 25 years, then in the initial year when MRP is made, C will be equal to 25. In the second year, C will be equal to 24, and so on. The original estimate of the life is determined at the outset and should not be varied thereafter, even if in reality the condition of the asset has changed significantly (paragraph 11).

32. The formula allows an authority to make **voluntary extra provision** in any year. This will be reflected by an increase in amount B and will automatically ensure that in future years the amount of provision determined by the formula is reduced.

33. The alternative is the **annuity method**, which has the advantage of linking MRP to the flow of benefits from an asset where the benefits are expected to increase in later years. It may be particularly attractive in connection with projects promoting regeneration or administrative efficiencies or schemes where revenues will increase over time. Guidance on the calculation method is given by CIPFA in its publication *Practitioners Guide to Capital Finance in Local Government (2012 Edition).*

34. **Freehold land** (paragraph 12) cannot properly have a life attributed to it, so for the purposes of Option 3 it should be treated as equal to a maximum of 50 years. But if there is a structure on the land which the authority considers to have a life longer than 50 years, that same life estimate may be used for the land.

35. Provision for debt under Option 3 will normally commence in the financial year following the one in which the expenditure is incurred [paragraph 40]. But paragraph 41 of the guidance highlights an important exception to this rule. In the case of the provision of a new asset, MRP would not have to be charged until the asset came into service and would begin in the financial year following the one in

which the asset became operational. This “**MRP holiday**” would be perhaps 2 or 3 years in the case of major projects, or possibly longer for some complex infrastructure schemes, and could make them more affordable. There would be a similar effect in the case of Option 4 under normal depreciation rules.

Option 4: Depreciation Method [paragraphs 36 to 37]

36. Alternatively, for new borrowing under the Prudential system for which no Government support is being given, Option 4 may be used. This means making MRP in accordance with the standard rules for depreciation accounting.

37. Authorities will normally need to follow the standard procedures for calculating depreciation provision. But this Guidance identifies some necessary exceptions:

(a) MRP continues until the total provision made is equal to the original amount of the debt and may then cease.

(b) The capital receipt from the disposal of the asset may not be used for revenue spending, since that would run counter to the Government’s “golden rule”. Capital receipts may be used only as specified in regulation 23 of the 2003 regulations.

(c) If only part of the expenditure on the asset was financed by debt, the depreciation provision is proportionately reduced.

CONDITIONS FOR USING THE OPTIONS

Use of Options [paragraphs 38 – 39]

38. The intention is that Options 1 and 2 should normally be available only for **Government-supported borrowing**. Options 3 and 4 are meant to be used for all **self-financed borrowing**.

Commencement of MRP [paragraphs 40-41]

39. The Guidance recognises that MRP should not be provided for Assets under Construction. Long term projects, for example infrastructure or regeneration, may be transferred from **Assets under Construction** to **Assets in Use** over a number of years. Local authorities should consider commencing to provide MRP on debt, apportioned by when each stage of the project transfers to **Assets in Use**.

Estimated useful life of assets [paragraph 42]

40. The Government is concerned that some local authorities are making capital investments that can only be justified as being value for money, by providing for MRP over a much longer period that any debt instruments taken out to finance acquisition. Under current PWLB terms of trade, local authorities can always refinance their debt. However, it is impossible to guarantee that PWLB terms of

trade for new loans will remain unchanged over the lifetime of existing loans. If PWLB terms of trade changed for new loans, local authorities that had otherwise expected to be able to freely refinance existing debt may instead be required to choose between significantly increasing their annual charge to 'top-up' their MRP or develop other plans to manage increased liquidity risk on repayment of debt.

41. Whilst the normal maximum asset life has been set at 50 years, the Guidance recognises that there may be circumstances where this maximum can be prudently exceeded. By service functionality, the Guidance means assets that are directly used to deliver the functions of the authority. It does not include investment assets.

<u>Leases and PFI [paragraph43]</u>

42. At the time of drafting this Guidance, it is anticipated that proper practices for leases will move to being based on *International Financial Reporting Standard (IFRS) 16: Leases,* with effect from 1 April 2019, the effective date of this Guidance. However, at the time of drafting the extant proper practices are based on *International Accounting Standard (IAS) 17: Leases* and this Guidance maintains the provisions in relation to finance leases under that standard. Guidance in relation to finance leases under IAS 17 as adopted by proper practices should be used, until proper practices replace that standard with provisions based on IFRS 16.

43. IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is low value. Implementation of this standard is expected to bring more lease contracts, and the related assets and liabilities onto the balance sheet.

44. When these lease contracts along with the related assets and liabilities come onto the balance sheet, a local authority will increase its long term liabilities. This will increase the quantum of debt that MRP needs to cover. Generally accepted accounting practice requires these changes to be accounted for retrospectively, with the result that an element of the rental or service charge payable in previous years (and previously charged to revenue accounts) will be taken to the balance sheet to reduce the liability. On its own, this change in the accounting arrangements would result in a one-off increase to the capital financing requirement and an equal increase in revenue account balances.

45. This is not seen as a prudent course of action and the guidance aims to ensure authorities are in the same position as if the change had not occurred. It does this by recommending the inclusion in the annual MRP charge of an amount equal to the amount that has been taken to the balance sheet to reduce the

liability, including the retrospective element in the first year. (This approach will produce an MRP charge comparable to that under Option 3, in that it will run over the life of the lease or PFI scheme and will have a profile similar to what the annuity method gives). MHCLG recognises the complexity of the accounting in this area and acknowledges that the recommendations in paragraph 43 of the formal guidance and in this commentary may not be entirely appropriate in all cases. It will be open to authorities to consider a different approach to the calculation, subject to compliance with the overriding statutory requirement to make a prudent level of MRP.

Housing assets

46. As was the case under regulation 28 of the 2003 Regulations prior to its amendment by the 2008 Regulations, the duty to make MRP does not extend to cover borrowing or credit arrangements used to finance capital expenditure on housing assets [as defined in paragraph 12]. Options 1 and 2 above already automatically achieve this; and when using options 3 or 4 (or any other method) the authority should not take account of capital expenditure on housing assets.

47. The rationale for this is that assets held in the Housing Revenue Account are self-financing. Instead, local authorities with Housing Revenue Accounts are required to make a charge to their Major Repairs Reserve, to maintain the functionality of housing assets.

Investment Properties [paragraph 45]

48. Where a local authority classifies an asset as an investment property, it is declaring that it is holding that asset for commercial reasons. Therefore, it should fully provide for debt taken on to acquire that asset over the lifetime of that debt. In addition as investment properties are not subject to depreciation, Option 4 – the depreciation method, is not appropriate for calculating prudent provision.

49. The Guidance recognises that some local authorities may have made different assumptions when they acquired investment properties. For this reason the maximum life that should be used for calculating MRP on such assets has been set at 50 years, which is the maximum loan period for PWLB debt.

Capitalised expenditure [paragraphs 46 – 47]

50. Authorities may borrow to meet expenditure which is treated as capital expenditure by virtue of either a capitalisation direction (section 16(2)(b) of the 2003 Act) or regulation 25(1) of the 2003 Regulations. The guidance recommends that MRP in such cases is determined under Option 3. However, since the expenditure does not relate (directly at least) to an asset for which a life can be estimated, guidance is given on how to determine the value of the variable “C” in the formula in paragraph 9 of the guidance.

51. The table in paragraph 24 of the guidance gives the value of “C” for each of the categories listed in regulation 25(1). The basic principle is that, where the capitalised expenditure can be indirectly linked to an asset, the estimated life of that asset should be used.

52. In other cases, 25 years is proposed as a reasonable default. But for the acquisition of **share capital** (regulation 25(1)(d)), the slightly shorter period of 20 years is specified, because the aim of that regulation is to discourage the use of those particular forms of investment.

53. Similarly, 20 years is specified in the case of expenditure **capitalised by direction**, since the Government again does not wish to encourage reliance upon that practice.

54. It should be noted that the value of “C” given in each case applies only in the *initial* year of making MRP. Subsequently, the value will decrease by 1 in each successive year.

Annex C - Transitional arrangements

1. The Government wants to ensure that local authorities make prudent provision for the repayment of debt. The Government believes that it is for local authorities to assess what is prudent according to their circumstances. The proposals aim to continue to give local authorities flexibility to define prudent provision and to change the methodology that they use to assess this if needed.

2. There is no requirement for local authorities to make decisions based on prospective Guidance. It is for individual local authorities to make their own judgement as to whether they apply the current Guidance or the prospective Guidance to decisions that they take prior to 1 April 2019, in consultation with their external auditors where they feel that is appropriate. Government has no intention of seeking to second guess or comment on local decisions taken in accordance with local Standing Orders.

3. The Government does not expect any local authority to recalculate MRP charged in the 2017-18 financial year or any prior year due to the proposed changes in methodology. Where a local authority has changed the methodology that it uses to calculate prudent provision and generated what the current Guidance calls an 'overpayment' it can continue to incorporate that overpayment into future calculations of prudent provision.

4. As set out in **paragraph 15** of the statutory guidance, a local authority that changes the methodology it uses to calculate MRP in 2018-19 does not generate an overpayment by doing so.

5. Where a local authority has selected a long asset life for borrowing or has decided not to charge MRP on non-Housing Revenue Account debt, we would expect the calculation of future year's MRP to be made under the new guidance, as set out in the Government response following completion of the consultation. We have suggested maximum useful economic lives in the draft for consultation, but if any local authority believes that there are reasons why these maximums are inappropriate for borrowing to support particular activities, we would encourage them provide the evidence to us. If a local authority feels that it needs to adjust the useful economic lives that it is basing its MRP charge on, then that adjustment should only be applied to calculations made in 2019-20 and subsequent years.

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EAST HERTS COUNCIL

PERFORMANCE, AUDIT AND GOVERNANCE SCRUTINY COMMITTEE – 22 JANUARY 2019

REPORT BY EXECUTIVE MEMBER FOR FINANCE AND SUPPORT SERVICES

CAPITAL STRATEGY 2019 ONWARDS

WARD(S) AFFECTED: NONE

Purpose/Summary of Report

The MHCLG have revised the Investment and Minimum Revenue Provision Guidance, which includes the introduction of a capital strategy.

This report includes the first capital strategy since the revisions.

RECOMMENDATION(S) FOR FOR PERFORMANCE, AUDIT AND GOVERNANCE COMMITTEE: to recommend to the Executive that:	
(A)	**The Capital Strategy 2019 Onwards discussed in paragraphs 2.3 is agreed for submission to Elected Members (Audit and Governance Committee, Executive and Council).**

1.0 Background

1.1 Treasury management is defined as: ‘The management of the Council’s investments and cash flows, its banking arrangements, money market and capital transactions; the effective control of the risks associated with these activities; and the pursuit of optimum returns consistent with the Council's risk management policy for treasury management.'

1.2 This activity is supported by the council's appointed independent advisors – Link Asset Services.

1.3 Revised reporting is required for the 2019/20 reporting cycle due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011.

1.4 This report includes the first capital strategy since the revisions.

2.0 Report

2.4 Please refer to Capital Strategy in Essential Reference Paper 'B': Capital Strategy 2019 Onwards and note this is a live document that will continue to be updated throughout the year.

3.0 Implications/Consultations

3.1 Information on any corporate issues and consultation associated with this report can be found within **Essential Reference Paper 'A'**.

Background Papers
CIPFA Code of Practice on Treasury Management (2018/19)
CIPFA Prudential Code for Capital Finance in Local Authorities (2017)
MHCLG Investment Guidance
MHCLG Minimum Revenue Provision (MRP) Guidance

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ESSENTIAL REFERENCE PAPER 'A'

IMPLICATIONS/CONSULTATIONS

Contribution to the Council's Corporate Priorities/ Objectives*:*	Priority 1 – Improve the health and wellbeing of our communities Priority 2 – Enhance the quality of people's lives Priority 3 – Enable a flourishing local economy
Consultation:	Not Applicable
Legal:	The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management recommends that members be updated on treasury management activities regularly (Treasury Management Strategy Statement, annual and midyear reports). This report therefore ensures this Council is implementing best practice in accordance with the Code. The report fulfils the following legislative requirements: • Reporting of prudential Indicators in line with the requirements of the CIPFA Code of Practice. • Reporting to those charged with governance a mid-year treasury management report.
Financial:	Within the body of the report.
Human Resource:	Not Applicable
Risk Management:	Within the body of the report.
Health and wellbeing – issues and	Not Applicable

impacts:	
Equality Impact Assessment required:	No

East Herts Council
Capital Strategy
2019 Onwards

Contents

Introduction

The East Herts Council Capital Strategy provides a valuable opportunity for engagement with Full Council to ensure that overall strategy, investment ambition, risk appetite and governance procedures are fully understood by all elected Members and other Council stakeholders.

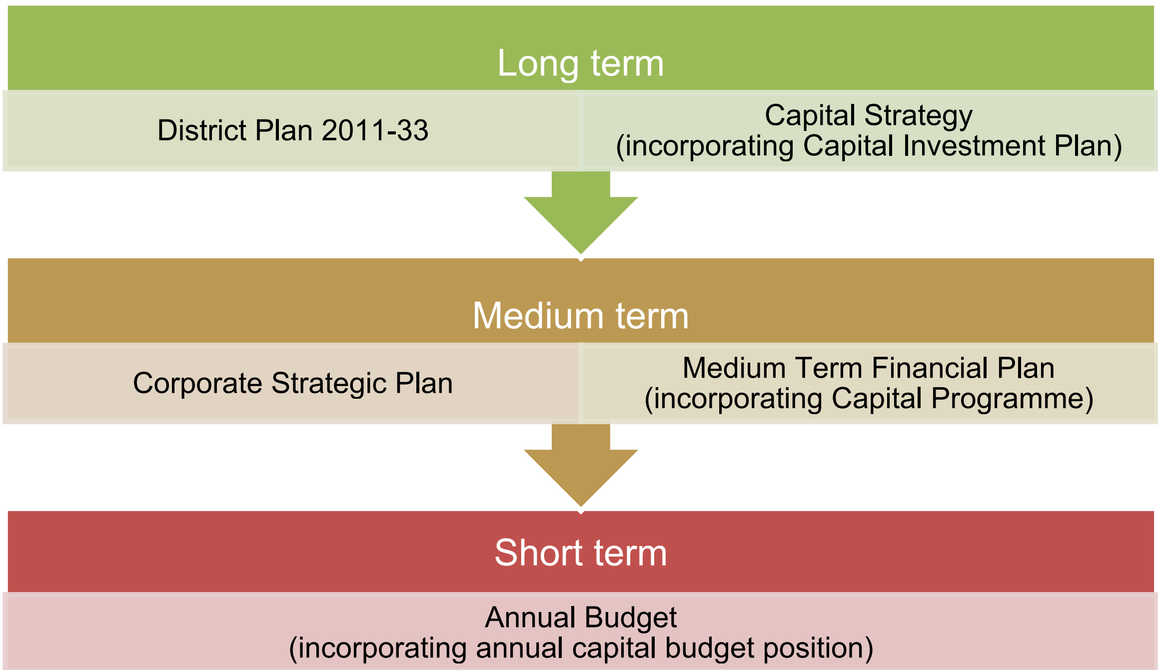
The East Herts Council Capital Strategy is intended is a strategic corporate strategy which will both be influenced by and in turn influence policy and decision making in respect of capital investment.

The Strategy will continue to develop and evolve as external influences do and will be updated as required in order that this Strategy is responsive to the challenges, opportunities, priorities and objectives that the Council must consider.

The CIPFA Prudential Code, updated in 2017, includes the requirement for local authorities to produce a Capital Strategy.

The Capital Strategy has not been developed in isolation. The diagram below summarises the relationship between this Capital Strategy and other key corporate strategies and plans.

Figure 1: Long, medium and short term strategic planning at East Herts Council



The Capital Strategy is closely aligned with the priorities and objectives contained within the above, as well as a number of external strategies and plans, which will be explored further in Section 2 of this Strategy.

This first draft of the East Herts Capital Strategy includes a number of important actions, which will help to implement the Capital Strategy across the organisation and improve overall financial planning in the long term. We recognise the benefits of long term strategic financial planning and therefore this Capital Strategy is seen as key to looking beyond the medium term to fully explore the opportunities which may lie ahead and the role the Council will play in shaping the future for our residents, communities and businesses.

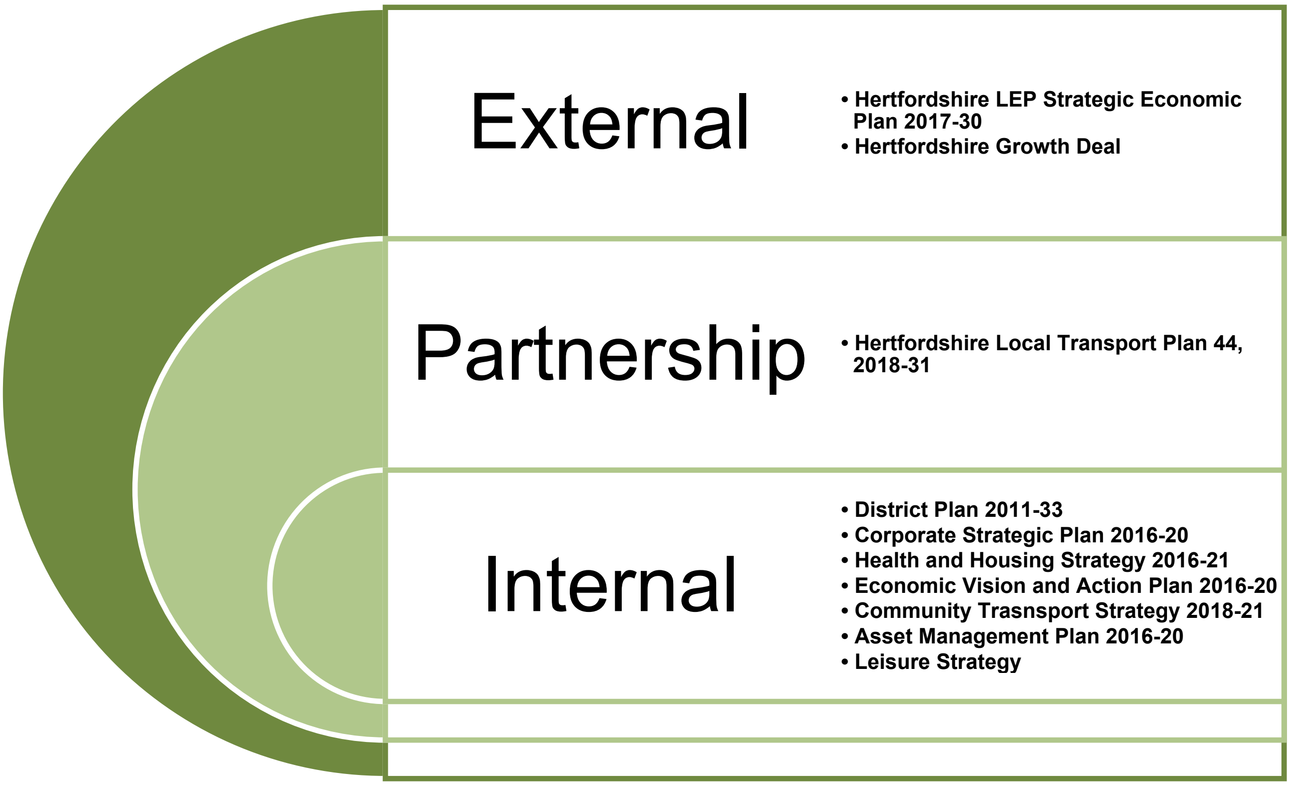
Influences on Capital Investment

The Capital Strategy is influenced by many different factors, which must be taken into account before establishing the appropriate strategy for contributing to the delivery of our corporate priorities.

Our Capital Strategy has considered external, partner and internal influences when shaping our approach. There are many strategies and plans that inform and influence our capital investment plan. It is important to ensure that consideration is given to the aims and objectives that could influence the Council's capital investment ambition over the longer term.

An examination of external and partner influences assists us with supporting decision making on individual capital investment schemes. In future we will therefore use external objectives / targets, alongside our own corporate priorities, to inform decisions making when prioritisation needs to be applied to available funding.

Figure 2: Core influences on the Capital Strategy



Our Capital Strategy has taken account of the external, partner and internal influences in shaping our approach. The following sections provide a summary of main points for consideration in each case:

External influences
Hertfordshire LEP Strategic Economic Plan 2017-30 and Hertfordshire Growth Deal
The strategic priorities, as set out in the Hertfordshire Local Enterprise Partnership (LEP) Strategic Economic Plan (SEP) 2017-2030, influence the Council's strategic financial planning direction. The Gilston Area Concept Framework is referenced as a key element of the SEP priorities, with the new Garden Town of Harlow & Gilston acknowledged by government as one of three new Garden Towns nationally. The new Garden Town initiative for Harlow & Gilston, links through to the now adopted District Plan, working to the detailed Gilston Area Concept Framework and the project governance that is in place via the Gilston Steering Group. The Growth Deal expanded further in 2017, with additional investment of £43.95m. The Council made a successful bid for Growth Deal funding for Bishop's Stortford Town Centre, an allocation of £9.6m in the form of grant and loan funding.

Link to Hertfordshire LEP Strategic Economic Plan 2017-30

Link to Hertfordshire Growth Deal

Partnership influences

Hertfordshire County Council Local Transport Plan 4

We acknowledge the recently updated Hertfordshire Local Transport Plan (LTP 4 2018-2031) and its main objectives.

The relationship with Hertfordshire County Council (HCC) is very important when considering the longer-term Capital Strategy for the Council. As a planning authority and billing authority, the Council is in a very influential position when it comes to setting the scene for the future development and growth in the area and considering the impact on funding streams at both the County and District level.

Over the coming year, we will examine any County capital schemes that are focused in the East Hertfordshire area, in order that the Council has sight of these schemes as they progress and any potential implications they may have for capital schemes being delivered by the Council, particularly related to our property partnership with the County and the green transport plan.

Link to Hertfordshire County Council Local Transport Plan 4, 2018 to 2031

Internal influences

District Plan 2011-33

The vision and strategic objectives contained within the District Plan influence the Council's investment ambition directly. It is important to provide a good view of the long-term impact of the District Plan in the Capital Strategy and the part that the Council's capital investment will play in contributing to meeting the long term needs of the local population and area.

The strategic objectives link to important regional activity, such as the London Stansted Cambridge Corridor Core Area, working with partner authorities, namely Broxbourne, Epping Forest, Harlow and Uttlesford across Hertfordshire and Essex County boundaries.

We currently determine that the District Plan currently has strategic influence on the following areas of important investment for the Council:

- Housing
- Town Centres
- Provision of leisure facilities

We will ensure that the Capital Strategy demonstrates the links to the District Plan strategic objectives and specific projects, as part of the capital investment plan.

Link to District Plan 2011-33 (adopted October 2018)

Corporate Strategic Plan 2016-20

The Corporate Strategic Plan drives the Council's capital investment ambition. The Corporate Strategic Plan includes reference to strategic projects for each year against the aims that support the three priority areas. When the Corporate Strategic Plan is refreshed we will ensure that the Capital Strategy links the capital investment plan to the relevant strategic projects and will therefore demonstrate how the Council's capital investment will contribute to the achievement of the Plan priorities and more detailed aims.

This will help with the evaluation and prioritisation of future capital schemes, where a business case needs to consider the contribution to the achievement of priorities, as well as non-financial and financial benefits.

Link to Corporate Strategic Plan 2016-20

Health and Housing Strategy 2019-23

We recognise that it is important for the objectives in the Health and Housing Strategy to be reflected in the Council's Capital Strategy both from a direct capital investment perspective and an enabling perspective. The Council plays a vital role in ensuring that the District Plan is delivered in terms of projects, housing mix, health focus and timescale.

The Health and Housing Strategy highlights the importance of working in partnership, particularly related to affordable and suitable housing to meet identified needs. Any associated capital investment requirement can be put into this context in the Capital Strategy to demonstrate how this investment is contributing to the achievement of important health and housing targets.

Link to Health & Wellbeing Strategy 2019-23

Economic Vision and Action Plan

The Economic Vision for East Herts sets out the strategic areas of focus in order to achieve this vision. The Economic Vision is backed up by a detailed action plan, which assists with making links to the Hertfordshire LEP SEP, Corporate Strategic Plan and District Plan.

The Economic Vision picks up the thread for major projects, such as the development of a planning framework for Bishop's Stortford Town Centre, which has since resulted in a significant funding package via the Hertfordshire LEP from the Growth Fund. Also, the London Stansted Cambridge growth corridor initiatives, where mention is made of lobbying for the right infrastructure.

The Council has already achieved success in lobbying and bidding for regional funding. As the Capital Strategy is developed it will further contribute strong evidence of local need and highlight where the Council cannot deliver as an individual authority and / or has not got sufficient available capital resources.

Link to Economic Vision and Link to Action Plan 2016-2020

Emerging Leisure Strategy

It is important to demonstrate the Council's Leisure Facilities Strategy in the Capital Strategy to make the direct strategic link to the capital investment plan. This provides strong justification for the significant planned investment and demonstrates why this service area is being prioritised.

These are very important initiatives, which are directed at the Council's community, to improve health and wellbeing across the area, working with health partners, town and parish councils, voluntary sector and community groups. This is important context for the significant planned capital investment by the Council, already included in the Capital Programme.

As the delivery of the Leisure Facilities Strategy progresses, we will reflect the emerging expected outcomes in future Capital Strategy updates, both from a financial and outcome perspective.

Vision for Leisure Facilities

In order to provide the guiding principles for the proposed direction of travel it was important to work with a vision for leisure centres across East Herts. It is proposed that the vision is one of enabling everyone to have the opportunity to participate. The Council has a pivotal role in providing pay and play opportunities which traditionally are not provided through other sectors. In this context the suggested vision is as follows:

"The Council will provide attractive facilities available to the whole community which complement the wider provision of recreation opportunities in the community and voluntary sector. In addition, it will ensure that leisure facilities contribute fully to the health and wellbeing objectives of the Council."

Asset Management Plan 2016-20

The importance of the link between the Asset Management Plan (AMP), and its constituent asset categories, is stressed in the CIPFA Prudential Code. There is no doubt that the Asset Management Plan should inform the Capital Strategy, but this also works both ways. The vision and ambition that is articulated in the Capital Strategy should set the scene for the direction that the asset management, in any particular area of operation, should take.

There is an emphasis on the investment property portfolio in the aims, priorities and ambitions in the AMP. Highlighting the Council's good management of the current portfolio and the approach to due diligence and strong decision making for new property investment. There is also an emphasis on town centre improvements, which links to major projects, such as the work in Bishop's Stortford and the master-planning in the District Plan.

The key improvement priorities have been mapped to corporate priorities, outcomes, key milestones and timescales in the current AMP. We will ensure that this links effectively with the capital investment plan as work gets underway to refresh the AMP over the coming year.

Link to Asset Management Plan 2016/20

Financial Sustainability Policy

The Council's Financial Sustainability Policy is very important at a time when the spotlight has been put on local authority behaviour in addressing significant funding difficulties, particularly with regard to commercial activity.

The Council's commitments, set out in the Policy, will be closely linked with the Council's view on risk, proportionality and financial resilience in terms of reserves, as expressed in this Capital Strategy.

Link to Financial Sustainability Policy

Background and Context

Like many local authorities East Herts council finds itself expected to deliver more and higher quality services while funding from central government reduces.

Financial sustainability

The sustainability agenda in terms of finance refers to councils which, often using the powers of General Competence from the Localism Act 2011, have explored and set-up different funding streams to ensure a sustainable mid to long term financial position.

Local authorities are finding new ways to raise money (and reduce spend) by making investments and initiating projects that create profit to organisational continuity.

East Herts council will:

- *Move into other areas of business to raise revenue from new sources*
- *Find newer and more efficient ways of working*
- *Explore new ways of working with business and charity sector as an enabler, not just provider*
- *Invest for return in new ventures such as commercial property investments*
- *Do this with sensitivity to market conditions and operators not giving ourselves undue advantage within the market.*

Core influences action plan:

Action	Why is this required?	Responsibility	Timescale
We will ensure that the Capital Strategy demonstrates the links to the **District Plan** strategic objectives and specific projects, as part of the development of the capital investment plan	In order to identify how we can strengthen our decision making and prioritisation process, informing what we are doing directly towards these objectives via capital investment	Management Team	During 2019/20
When the **Corporate Strategic Plan** is refreshed we will ensure that the Capital Strategy links the capital investment plan to the relevant strategic projects	In order to continue to demonstrate how the Council's capital investment will contribute to the achievement of the Corporate Strategic Plan priorities and more detailed aims	Strategic Finance & Property, S151 Officer	In line with Corporate Strategic Plan refresh timescale
As the delivery of the **Leisure Facilities Strategy** progresses, we will reflect the emerging expected outcomes in future Capital Strategy updates, both from a financial and outcome perspective	In order to demonstrate the importance of this major element of the capital investment plan and the intended outcomes for the future	Strategic Finance & Property, S151 Officer	During 2019/20
The key improvement priorities have been mapped to corporate priorities, outcomes, key milestones and timescales in the current **Asset Management Plan**, we will ensure that this links effectively with the capital investment plan as work gets underway to refresh the AMP over the coming year.	In order to strengthen the influence of the AMP on the Capital Strategy and also enable the Capital Strategy intention and ambition to inform the emerging refreshed AMP	Management Team	In line with AMP refresh timescale

Capital investment ambition by Corporate Priority

The intention of this section is to set out the long-term ambition for capital investment in terms of the contribution made towards achieving the priorities identified in the Council's Corporate Strategic Plan. The future intention will be to articulate the capital investment plan in terms of achievement of priorities, intended outcomes for all key stakeholders and intended timescales.

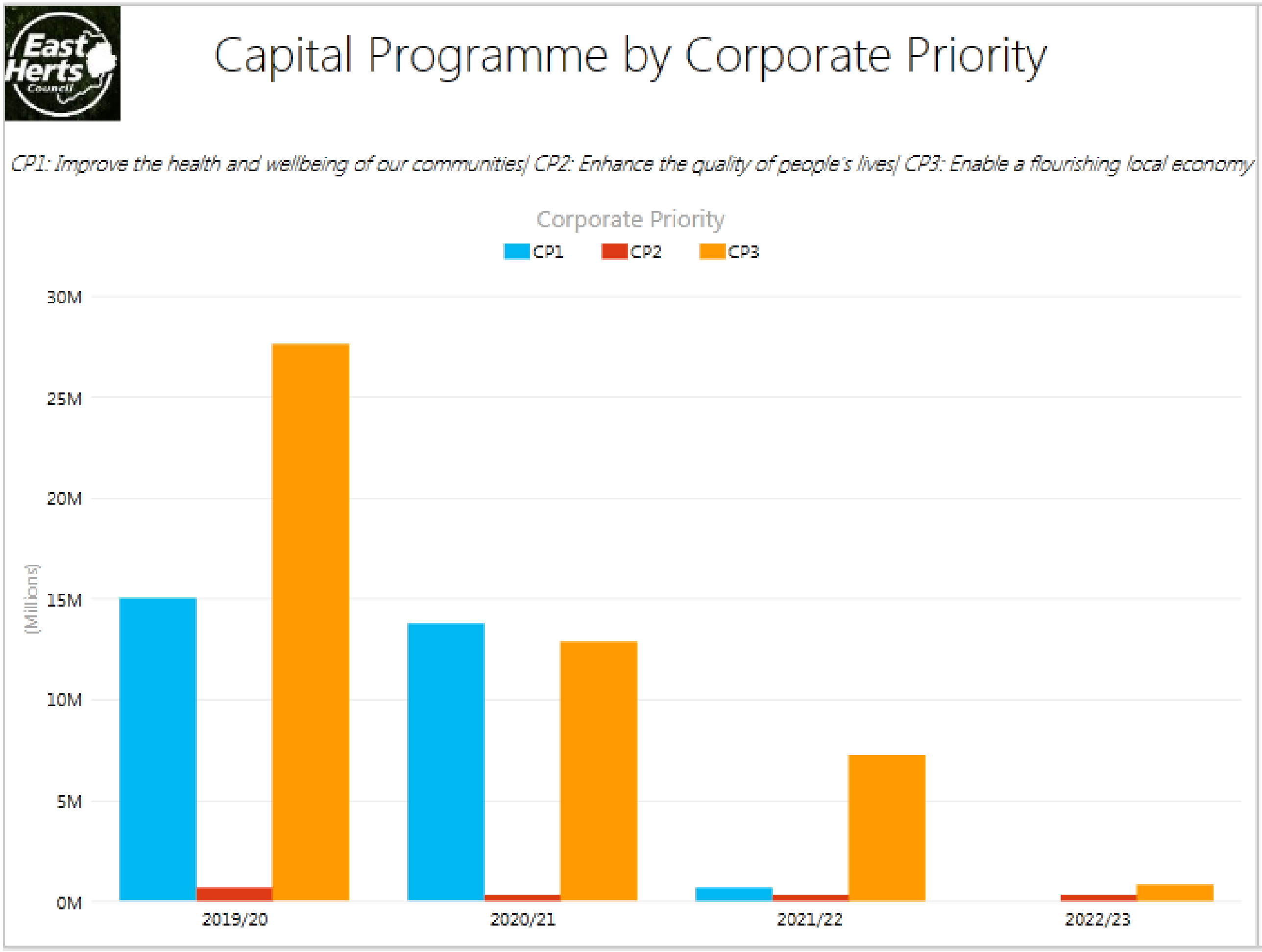
At this initial development stage, we can only set out the current Corporate Strategic Plan priority initiatives to demonstrate our current approach ahead of producing a longer-term capital investment plan. We have set out the Corporate Strategic Plan initiatives below which relate to capital investment:

Priority	Aims and initiatives
Priority 1: Improve the health and wellbeing of our communities	***Residents living active and healthy lives*** • Invest in our parks and open spaces to encourage health, fitness and biodiversity including improvements to Grange Paddocks, Hartham Common and Presdales Recreation Ground – **Ongoing** • Produce a leisure strategy to determine future direction and planning for the council's two Leisure Centres and three joint use swimming pools – **Ongoing** ***Communities engaged in local issues*** • Support communities in rural areas with accessing infrastructure for super-fast broadband – **Ongoing** • Move all services to a platform of digital delivery whilst still ensuring face to face and telephone services are maintained for those who need them – **Ongoing**
Priority 2: Enhance the quality of people's lives	***Attractive places*** • Deliver successful Heritage Lottery Fund Stage 1 bid for Waytemore Castle (Bishop's Stortford) and deliver management plan for Hertford Castle Grounds (in partnership with the Town Council) – **Ongoing** ***Future development best meets the need of the district and its residents*** • Publication and adoption of the District Plan – **Achieved** • Seek to shape development proposals for key sites in the district including the broad locations for development identified in the District Plan – **Ongoing** • Support and maximise the provision of additional affordable housing in association with developers and registered providers – **Ongoing** • Undertake feasibility work on setting up a company to build new homes – **Ongoing**
Priority 3: Enable a flourishing local	***Support for our businesses and the local economy***

Priority	Aims and initiatives
economy	• Work with the Local Enterprise Partnership on the "growth hub", an enterprise network for small businesses that are seeking to grow – **Ongoing** • Deliver the EU-funded Rural Development Programme to support business growth – **Ongoing** ***Vibrant town centres*** • Develop a planning framework for Bishop's Stortford, focusing on Old River Lane and key adjoining town centre sites and develop a masterplan for Old River Lane – **Ongoing** ***Working with others, to have achieved the right infrastructure for our businesses and communities*** • Work with key partners such as the Local Enterprise Partnership, County Council and London Stansted Cambridge Consortium on identifying infrastructure requirements and ways to bring them to fruition – **Ongoing** • Work with key partners such as the County Council on sustainable transport solutions for East Herts, including community transport and green travel planning – **Needs further work**

We reported our planned capital investment, from an expenditure perspective, to the Executive in December 2018. At this stage we have undertaken a simple mapping exercise to demonstrate the contribution of planned capital investment to each Corporate Strategic Plan priority. This will be developed further as the Capital Strategy is strengthened during 2019/20.

Figure 3: Capital Programme by Corporate Priority



In terms of focus and prioritisation, it is important to note that 84% of the planned capital expenditure in the 4-year Capital Programme (from 2019/20) relates to just four key capital schemes. We have examined the broad contribution that each of these schemes makes towards the achievement of our corporate priorities in the table below. Links between the rest of the 4-year capital programme and the corporate priorities are provided at Appendix A.

	Improve the health and wellbeing of our communities	Enhance the quality of people's lives	Enable a flourishing local economy
Grange Paddocks Leisure Centre	✓	✓	
Hertford Theatre		✓	
Millstream Property Company		✓	✓
ORL Development			✓

Corporate priority action plan:

Action	Why is this required?	Responsibility	Timescale
As the **longer-term capital investment plan** emerges, we will undertake a more detailed mapping exercise against each capital scheme – initially in the capital programme and eventually in the longer-term capital investment plan	This will assist Members and other key stakeholders recognise the contribution that the capital investment is making towards the achievement of the Council's corporate priorities	Strategic Finance & Property, S151 Officer	During 2019/20
As the refreshed **Corporate Strategic Plan** emerges, we will ensure that the existing capital investment plan is reviewed to ensure that all planned schemes align with the updated corporate priorities	This will ensure that existing investment plans still meet the identified needs of the District and emerging pipeline schemes are aligned to the newly approved priorities	Strategic Finance & Property, S151 Officer	In line with Corporate Strategic Plan refresh timescale

Commercial Investment Strategy

In our Financial Sustainability Policy, we set out a vision statement:

For East Hertfordshire District Council to be an innovative authority that safeguards its future through maximising financial independence from government funding sources. It will do this by raising its own revenue through non-traditional ways and smarter spending.

Financial sustainability is about ensuring the council can continue to discharge its duties to the public whilst keeping a balanced and sustainable budget, proving itself a responsible custodian of the public purse.

We also set out our intention, saying that we will:

- Move into other areas of business to raise revenue from new sources
- Find newer and more efficient ways of working
- Explore new ways of working with business and charity sector as an enabler, not just provider
- Invest for return in new ventures such as commercial property investments
- Do this with sensitivity to market conditions and operators not giving ourselves undue advantage within the market.

With regard to our approach to investment properties, our Asset Management Plan states the following:

These assets are held in order to generate a return on investment for the council. The investment property portfolio generates a source of income for the council which makes a significant contribution to the ongoing financing of council services, ensuring the financial sustainability of the council as government funding reduces.

These assets are subject to a review process to ensure that the return on investment is maximised and opportunities for development are actively explored to secure these returns in the medium to long term.

Where opportunities to acquire further investment properties occur, these will be explored, subject to the relevant due diligence processes. The council will also seek to hold investment properties in the most suitable structure including joint venture/partnership arrangements or wholly-owned local authority trading companies.

Millstream Property Investments Limited

In line with the Council's corporate priorities, and commercial investment ambition, Millstream Property Investments Limited was incorporated in February 2018.

The council, as the company's sole shareholder, has entered into a Shareholder Agreement with the company. The Shareholder Agreement obliges the company to annually review its business plan and produce a revised 30-year business plan, rebasing the forthcoming financial year as the first year of this 30-year period.

The company presented its revised 30-year business plan for the period commencing 2019/20 in December 2018. As required by the Shareholder Agreement, the company's 30-year business plan includes:

- a schedule of properties and/or sites to be acquired in the next financial year whether described by name or the number and/or value of specific types of property at least differentiating residential and commercial and existing built properties and sites
- a financial business plan covering not less than 30 years based on development and management and maintenance of existing assets and acquisition of planned new assets
- a procurement plan which shall include details of contracts coming to an end and contracts to be tendered
- an asset management plan including management, maintenance, disposals and acquisitions plans
- key performance indicators with previous performance and targets for the coming financial year; and
- estimates, assumptions regarding reinvestment of profits, distribution of dividends and capitalisation of profits for the coming financial year including the amounts it will be prudent to retain in order to meet operational costs in the coming financial year and the amounts available for distribution to the Shareholder.

The council has asked the company to take a longer view of property acquisitions, development and disposals than just the coming year and so the proposed business plan includes a number of proposals which would see a pipeline of additional properties coming into the company's ownership up until 2022/23.

In overall terms, the company sought approval of its business plan which will:

- increase the company's portfolio of residential properties from three properties at December 2018 to 49 properties by 2022/23, consisting of a mix of private rented homes, affordable rented homes and low-cost home ownership properties;
- provide the council with an annual revenue income stemming from interest on commercial loans extended to the company, sale of services to the company and dividends payable by the company;
- require loan capital and grant funding from the council.

We aim to develop a more detailed commercial investment strategy, as part of the further development of the Capital Strategy, as we recognise that there is continuing scrutiny of local government commercial activity and the effective management of the risk position by individual authorities.

The CIPFA Prudential Code, Treasury Management Code of Practice and the MHCLG Investment Guidance have all been updated, with a particular focus on commercial activity. CIPFA has also stated that it intends to issue further guidance in this area of investment in the near future and the announcement of the provisional settlement for local government for 2019/20 included a statement on the potential for government intervention.

Commercial investment strategy action plan:

Action	Why is this required?	Responsibility	Timescale
Develop a more detailed **commercial investment strategy**, as part of the further development of the Capital Strategy for 2020/21	This will ensure that we are clear on our intention and expected outcome from commercial investments, which links to our process for undertaking new investments and effectively managing the commercial portfolio	Management Team	During 2019/20

Capital Investment Plan

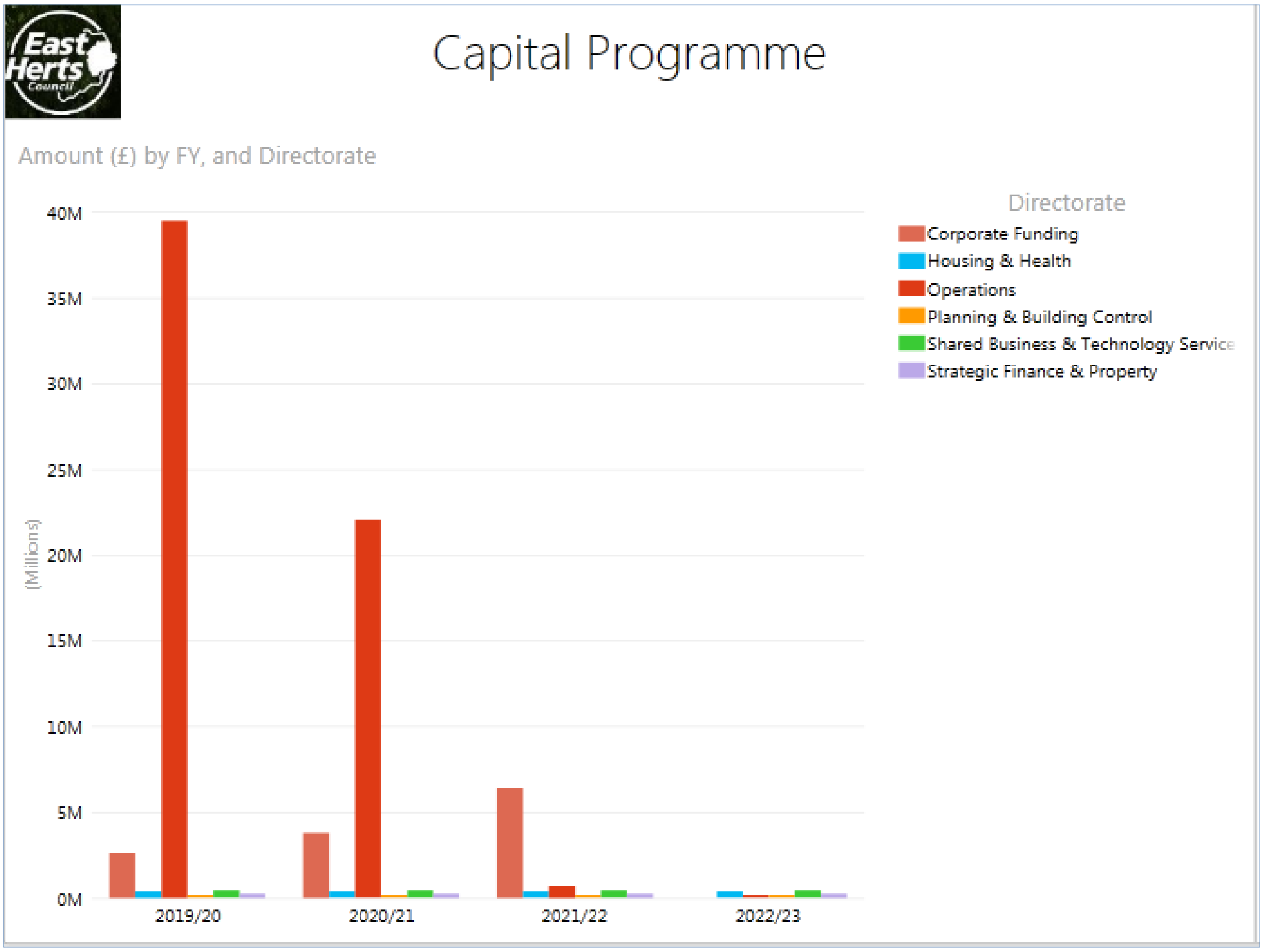
The following sections examine our starting point for a longer-term capital investment plan, the additional analysis that informs our Capital Strategy principles, our capacity to deliver and the potential options for addressing our capital investment ambition gap. We recognise that our Capital Programme currently plans for investment over a four-year period, which is a medium-term view and there is further work to do to extend our plans up to 10 years.

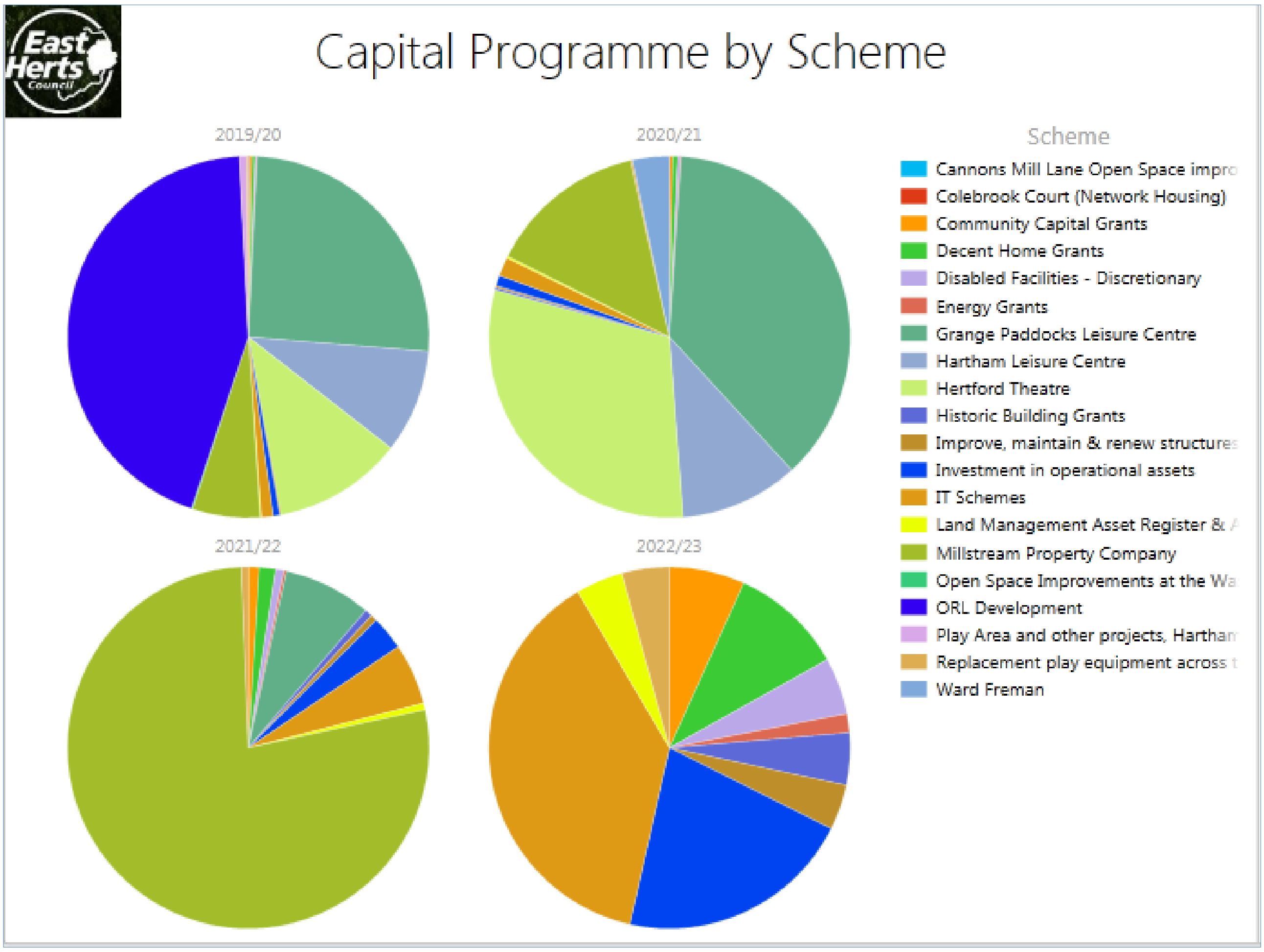
When our strategic planning becomes more mature, and we have identified our plans beyond the four-year horizon, we will update our process for evaluation and prioritisation, to ensure that there is clarity on the level of affordability, based on available capital resources, including a potential borrowing position. It is also important for the Council to establish its potential lobbying position to seek to secure future funding packages from appropriate funding bodies, building on successful bids to date.

We will ensure that our risk assessment examines the risk against the affordability and deliverability assumptions, as the longer-term capital investment plan emerges, and this will inform the ongoing review of performance and update of the capital investment plan to ensure that it is effectively managed.

The following charts provide a view of the current four-year investment plan from an expenditure perspective by Directorate:

Figure 4: Capital Programme by Directorate





Approach to capital investment prioritisation

The Medium Term Financial Plan (MTFP) is refreshed annually to accommodate changes in service delivery and financial landscape. Service and financial planning are combined in one report, which demonstrates that we have got an integrated approach to financial planning both from a revenue and capital perspective.

The MTFP is forecast over a 4-year period, in line with the Council's general corporate planning approach. The MTFP sets out the national policy context and describes the impact of this at a local level. It must be recognised that, when looking at a four-year period, the current level of uncertainty makes this an increasingly challenging exercise.

When considering an appropriate long-term period for the Capital Strategy, we are potentially looking at a 20-30 year period but a more realistic period for the capital investment plan, say up to 10 years. This longer-term approach enables a much more robust 4-year Capital Programme forecast and a strong annual budget.

We recognise that the MTFP should be able to articulate the Council's revenue and capital investment plans in the context of a longer-term approach. On this basis, our view is that the MTFP approach needs to be dynamic and aligned to the Council's Corporate Strategic Plan priorities, following an appropriately detailed business planning approach. We feel that the budget setting and service planning process goes a long way towards achieving this approach, however, when it comes to the capital planning process we recognise that we need the process to be less reactive and much more proactive.

As stated in the Budget report to the Executive in December 2018, the capital programme for 2019/20 onwards contains a number of newly agreed capital schemes and also the rolling schemes agreed in previous years.

Currently the review of the Capital programme is undertaken as part of the quarterly health-check report. Any additions to the programme require a funding request to be made through the appropriate governance process. This process is defined by the value of the capital bid.

The council is likely to undertake a number significant capital schemes within the medium term including Old River Lane, Bishop's Stortford. The scope and funding arrangements of such schemes are still in the early stages of project planning. However, it should be noted that East Herts may need to give careful consideration to its reserves provision in the forthcoming years and will potentially require a borrowing facility within this medium term financial period.

As any of these schemes are agreed and the funding requirements become more definite these schemes will be included in the capital programme presented within the quarterly health-check report.

As we develop the Capital Strategy we intend this to become better informed over time and strengthened by the capital investment plan, which will stretch up to 10 years. We recognise that it is important to identify all required capital investment commitments, to ensure that all existing capital commitments are required, particularly in light of any refresh of the Corporate Strategic Plan, and that potential commitments from emerging new proposals and ideas are reflected.

We also recognise that, if we have any business as usual commitment missing from our capital investment plan, capital schemes that will no longer deliver against corporate priorities, known capital investment ambition not reflected and a short to medium term delivery profile, it is difficult for is to have a strong capital financing requirement, which in turn will not give us a good view of our potential borrowing requirement in the future.

As we develop our Capital Strategy further in the coming financial year we will make sure that our capital investment plan is comprehensive and profiled realistically, so that the revenue consequence, both positive and negative, are as robust and risk aware as possible, to feed into the budget and the medium term financial plan.

Resource allocation and borrowing principles

Capital investment plan action plan

Action	Why is this required?	Responsibility	Timescale
Agree **an appropriate long-term period** for	To enable the Council to plan much more effectively for the	Council	During 2019/20

Action	Why is this required?	Responsibility	Timescale
the Capital Strategy – potentially up to 30 years, based on the timeframe of the Council's current strategies, plans and commercial activity	future – affording time to be clear about risk appetite, management of risk and management of financial resilience		
Develop a **longer-term capital investment plan** – potentially up to 10 years, based on an appropriate timescale to suit the agreed period of the Capital Strategy	To enable the Council to improve its capital planning process, strengthen the Capital Programme and assist the effectiveness of delivery against plan	Management Team	During 2019/20
Improve the **integration with the Council's financial plans and strategies** – particularly the MTFP, Treasury Management Strategy, Annual Investment Strategy and Reserves Strategy	To enable an overall view of the Council's delivery of a prudent, affordable and sustainable capital investment plan that contributes positively to the achievement of the Council's corporate priorities	Strategic Finance & Property, S151 Officer	During 2019/20

Risk Management

Risk Management Strategy

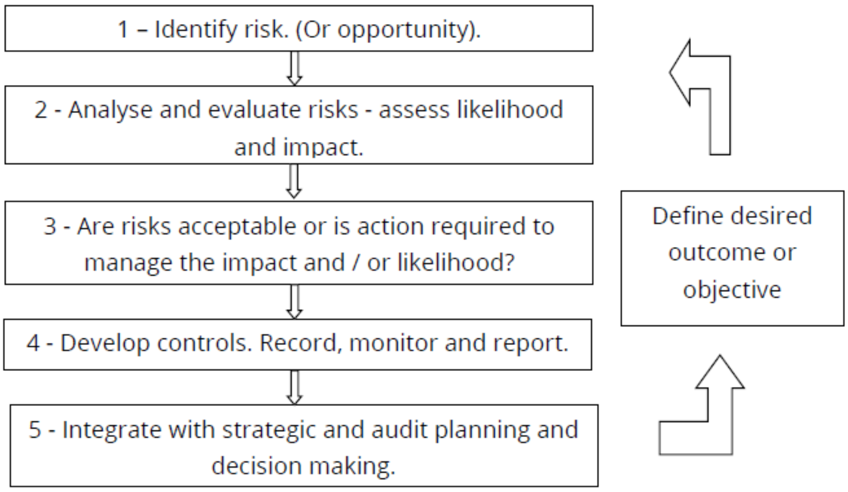
The Council's Risk Management Strategy was last reviewed in spring 2018 and is reviewed on an annual basis.

The Strategy contains a clear definition of risk management as follows:

The process which aims to help organisations understand, evaluate and take action on all their risks with a view to increasing the probability of their success and reducing the likelihood of their failure. (Source: The Institute of Risk Management).

The five stages of risk management are summarised in the diagram below, extracted from the Risk Management Strategy.

Figure 5: Stages of Risk Management



Risk Evaluation and Risk Appetite

The Risk Management Strategy includes a scoring matrix to be used in analysing and evaluating risks as outlined in the image overleaf.

Figure 6: Risk Scoring Mechanism

4 - HIGH >£300,000 and / or national criticism and / or catastrophic fall in service quality				
3 – MEDIUM £150,000 to £300,000 and / or regional criticism and / or major long term fall in service quality		CONTINGENCY	CRITICAL	
2 – LOW £50,000 to £150,000 and / or long term local media criticism and / or minor long term or major short term fall in service quality		CONTROL	CAUTION	
1 - NEGLIGIBLE <£50,000 and / or short term local media criticism and / or short term fall in service quality				
IMPACT / LIKELIHOOD	**1 - RARE** The event could occur in exceptional circumstances	**2 - UNLIKELY** The event could occur less frequently than every three years	**3 - POSSIBLE** The event is likely to occur within, or more than one in three years	**4 - PROBABLE** The event is likely to occur within a year

The Strategy includes a definition of the Council's risk appetite i.e. the level of risk that it is prepared to tolerate without need for ongoing monitoring or reporting.

A material risk is deemed to be any risk rated higher than 2:2 on the scoring mechanism above. Where a risk rating exceeds this 'control' area of tolerance, demonstrable evidence of how risks are being mitigated will be required, together with proposals for future controls.

The Risk Management Strategy acknowledges that with increasing pressure on public finances, Local Authorities are obliged to have more appetite for risk. The Council cannot deliver everything it would ideally like to deliver and tough choices are necessary. The Council is therefore open to considering all delivery options, accepting increased levels of risk in order to secure the successful outcomes or rewards.

Risk management is essential in supporting innovation and moving from a 'risk averse' to a more 'risk aware' approach. An example is the acquisition of Old River Lane, Bishop's Stortford. The financial commitment is significant but the acquisition provides an opportunity to shape the town centre, and an additional income stream.

Roles and responsibilities

Roles and responsibilities are contained within the Risk Management Strategy and summarised here for ease of reference:

Role	Responsibility
Elected Members	Elected Members are responsible for governing the delivery of services to the local community. Members have a responsibility to understand the strategic risks that the Council faces, and will be made aware of how these risks are being managed. All Members will have the responsibility to consider the risks associated with the decisions they undertake and will be informed of these risks in the reports that are submitted to them. They cannot seek to avoid or delegate this overall responsibility, as it is key to their stewardship responsibilities. All Members can access strategic risks on Pentana Performance (formerly called Covalent).
Full Council	Full Council recognises the importance of effective risk management and considers risk management issues when making decisions.
Executive	To receive an annual report regarding the content of the Strategic Risk Register, then three exception reports each year detailing any change in risk scoring and the reasons why. Agree the Risk Management Strategy on an annual basis, or if significant changes require a revision. Agree / set the Council's risk appetite.

Role	Responsibility
	Allocate sufficient resources to address top risks.
Performance, Audit and Governance Scrutiny Committee	To develop policy options and to review and scrutinise the policies of the Council including Risk Management. To monitor the effective development and operation of risk management and corporate governance in the Council. Receive an annual report regarding the content of the Strategic Risk Register, then three exception reports each year detailing any change in risk scoring and the reasons why.
Chief Executive and Leadership Team	To ensure that effective systems of risk management and internal control are in place to support the Corporate Governance of the Council. Take a leading role in identifying and managing the risks and opportunities to the Council and to set the example and standards for all staff. Advise the Executive and Council on the risk management framework, policy, strategy and processes. Advise on the management of strategic and other significant risks. Ensure that the Policy and Strategy are communicated, understood and implemented by all Members, managers and staff. To report to Members on the management of strategic risks. To ensure that the risk management process is part of all major projects, partnerships and change management initiatives.
Heads of Service	To be individually responsible for their service risks. Be actively involved in the identification and assessment of risks through the service planning process. Ensure that all reports of a strategic nature written for Members include risk commentary. To implement the detail of the Risk Management Strategy and risk related corporate policies, e.g. Health and Safety, Data Protection. Ensure that significant service risks are considered by Leadership Team quarterly.
Strategic Finance and Property	Co-ordinate risk management activities and prepare related reports for management and Members. Review and develop the Risk Management Strategy and processes. Facilitate / arrange risk management training for staff and Members.

Role	Responsibility
	To co-ordinate the Business Continuity Plan. Support the risk based audit planning process.
Shared Internal Audit Service	To provide assurance to the Council through an independent and objective opinion on the control environment comprising risk management, control procedures and governance. To provide an annual Audit Plan that is based on a reasonable evaluation of risk, and to provide an annual assurance statement to the Council based on work undertaken in the previous year. Review and challenge the effectiveness of the risk management framework.

Monitoring

Existing controls of strategic risks, their adequacy, new mitigation measures and associated action planning information are to be recorded on the Strategic Risk Register.

Strategic risks are subject to one detailed annual report with quarterly reports on an exception basis only.

Capital Risk Register

Risk Category	Description of Risk / Uncertainty	Mitigating Factors	Timescale (for review / implementation)	Owner	Residual Risk Score
Political					
Finance	There is uncertainty around future funding, both from Government and other areas such as income from commodities markets for recycled materials.	Funding situation is being carefully monitored.	Ongoing	Management Team	3
Social					
Technological					
Legislative / Legal	Challenges to legal powers being	Robust technical,	Ongoing	Management Team	6

Risk Category	Description of Risk / Uncertainty	Mitigating Factors	Timescale (for review / implementation)	Owner	Residual Risk Score
	employed to deliver capital ambition	expert and legal advice to be sought as required in order to demonstrate that the Council's actions are justified			
Continuity / service delivery	Risk of not having capacity / capability and flexibility to continue to deliver service levels over time.	Services have restructured to ensure their services meet customer demand and are efficient and effective. Digital East Herts will support this transformation.	Ongoing	Heads of Service	4
	Risk of lack of defined process resulting in disrupted service delivery as decision making processes are impaired	The Management Team are to consider standardisation of business cases, project evaluation and scoring mechanisms to aid decision making and prioritisation of resources	12 months	Management Team	5
Environmental	Development of Old River Lane, Bishop's Stortford: impact on	Site options being developed by urban designers and property	Ongoing	Head of Service	5

Risk Category	Description of Risk / Uncertainty	Mitigating Factors	Timescale (for review / implementation)	Owner	Residual Risk Score
	surrounding area	consultants. Discussions ongoing with other partners such as Hertfordshire County Council, Rhodes and Bishop's Stortford Town Council, to ensure any enabling parts of the site are ready			
Competitive					
Customer / citizen					
Managerial / profession					
Partnership / contractual					
Physical					

Risk Management action plan

Action	Why is this required?	Responsibility	Timescale
Monitor operational and strategic risks and update relevant risk registers accordingly, reporting strategic risks annually or quarterly by exception	In order that opportunities are explored in full in a timely fashion, and that risks are acknowledged and managed effectively through project lifecycles	All	As required and at least on a quarterly basis

Capital Investment Appraisal Process

Business planning process

The current business planning process for developing investment proposals to be included within the Council's future financial plans is summarised in the diagram below.

Figure 7: Business Planning Process

Summer	Autumn	Winter	Spring
• New capital investment proposals drafted	• Management Team consider draft proposals	• Elected Members consider draft proposals	• Elected Members approve capital investment proposals

New proposals are developed by individual Project Managers, approved for consideration at service level by the Service / Directorate Manager following which, the proposals will be considered by Management Team and successful proposals will progress for consideration and approval as part of the annual budget cycle.

Investment proposals – consultation and stakeholder engagement

Consultation and engagement is a key part of developing individual proposals and will tailored to the individual proposal and relevant stakeholders both internal and external to the Council. stakeholder engagement and consultation can take place throughout the lifecycle of a proposal (from initiation to close down) and the outputs of any engagement or consultation undertaken should be used to inform the proposal as this progresses.

The diagram below summarises the elements to consider in developing capital investment proposals.

Figure 8: Stakeholder engagement and consultation in developing investment proposals

Developing capital investment proposals – description of current processes

Project and Service Managers are encouraged to consider a range of options in developing individual proposals to determine an appropriate way forward, and to capture project details as a business case. However, although new proposals are required to develop a business case, there is as yet no standardised business case template used consistently across the Council to capture key information. This can lead to gaps in information being captured.

The Council has therefore identified that a standardised business case template is required, to support Officers in recording and maintaining project information and inform decision making. Business case must include estimates of capital costs, revenue implications and how the individual

proposal aligns with Council plans and strategies and any partnership or external plans and strategies as relevant. Risks should also be documented as part of developing the proposal, along with mitigating actions and relevant timescales.

Business cases would then be maintained throughout the lifecycle of a project to maintain accurate information relating to delivery and lessons learned should be captured as part of project closure reports.

Prioritising capital investment

The intention is for the standardised business cases referenced above to then be subject to a standardised evaluation process, the outcome of which will be the prioritised capital investment programme. Local authorities continue to face financial challenges and as a result, the need to prioritise and target investment is ever present.

The Council has identified that in order to effectively assess investment proposals against one another, a standardised evaluation process and scoring mechanism may be beneficial to help aid decision making and prioritise investment.

Project appraisal process action plan

Action	Why is this required?	Responsibility	Timescale
Consider a **standardised business case** documentation and **evaluation scoring mechanism** in order to develop and assess capital investment proposals	To support Officers in capturing and maintaining project information, from proposal to project close down, in order to help inform decision making and prioritise investment	Management Team	12 months

Governance

Description of existing approval mechanisms

The existing process for development and approval of the Council's Capital Strategy is summarised in the diagram overleaf.

Figure 9: Capital Strategy Approval process

The internal governance structure will need to be mindful of partners' and external governance mechanisms and will need to communicate and engage with these structures through delivery of the Council's overall capital ambition.

Roles and responsibilities

All Officers and elected Members have a role to play in informing and delivering the Capital Strategy. These roles and responsibilities are summarised below:

Role	Responsibility
Elected members	To approve the Capital Strategy and monitor delivery of the Strategy through various scrutiny forums
Management Team	To develop and propose the Capital Strategy for approval
Programme / Directorate Managers	To help inform the Capital Strategy, identifying constraints and opportunities and communicating to both Senior Management and Project Teams
Project Managers	To manage delivery of individual projects aligned to the Capital Strategy and to develop and maintain project information which will inform decision making processes and the direction and delivery of the Capital Strategy
Project Team members	To contribute to the delivery of individual proposals which align with the Capital Strategy

Skills and training

The Council benefits from the skills and experience possessed by both Officers and elected Members which will support delivery of individual capital proposals and the Council's overall capital ambition. The Council is also keen to support Officers and elected Members to continue to develop their skills sets and is therefore mindful of the implications capital proposals may have on the Council's workforce and future training opportunities and requirements.

The Council already has a programme of staff training available and will look to support those staff who wish to continue their professional development appropriate to their role and subject to appropriate budget availability. Relevant training for elected Members is also undertaken on a routine basis and refreshed as required.

Any skills or experience required which are not already possessed 'in-house' should be identified through individual capital proposals or business cases and will be procured externally as necessary, and in accordance with the Council's Corporate Procurement Strategy.

Capital Strategy engagement

The Capital Strategy is a corporate document which helps stakeholders understand the Council's capital investment objectives and decisions. The Council is therefore keen that the Capital Strategy is informed by knowledge and experience from across the authority.

There is still work to do in fully implementing developing and implementing the Capital Strategy as a corporate strategic document. Therefore, the Senior Management Team will consider a consultation and engagement plan over the coming months which will look to raise awareness of the Strategy and gather stakeholder input for future iterations of the Capital Strategy.

Capital Strategy date for review

The Capital Strategy is intended to be a dynamic document, responsive to changes in policy, strategic influences and delivery.

The Capital Strategy will therefore be updated as required and at least once on an annual basis.

Governance action plan

Action	Why is this required?	Responsibility	Timescale
Update the Capital Strategy as required and **at least once annually**	To maintain a dynamic and responsive Strategy which evolves as the Council's priorities do	Management Team	As required
Consider an **engagement plan** for the Capital Strategy	To continue to develop and inform the Capital Strategy, and raise awareness of the Council's capital investment ambition	Management Team	12 months

Signed: Isabel Brittain - Strategic Finance & Property, S151 Officer

Appendix A – Capital Programme by Corporate Strategic Plan priority

	Improve the health and wellbeing of our communities	Enhance the quality of people's lives	Enable a flourishing local economy
Compliance Works to Swimming Pools	✓	✓	
Leventhorpe Swimming Pool, Sawbridgeworth	✓	✓	
Joint Provision Pools (Ward Freman, Leventhorpe & Fanshawe) - Replacement Air Conditioning to Offices	✓	✓	
Investment in operational assets			✓
Hertford Theatre - Replace Auditorium Roof		✓	
IT Schemes			✓
Historic Building Grants			✓
Hartham Leisure Centre	✓	✓	
Ward Freman			✓
Open Space Improvements at the			✓

	Improve the health and wellbeing of our communities	Enhance the quality of people's lives	Enable a flourishing local economy
Wash, Hertford			
Folly View Open Space Improvements, Hertford			✓
Cannons Mill Lane Open Space improvements, Bishops Stortford			✓
Replacement play equipment across the district (in response to the Condition Audit to be reviewed in 2018/19)			✓
Play Area and other projects, Hartham Common, Hertford			✓
Energy Grants		✓	✓
Improve, maintain & renew structures along rivers and watercourses			✓
Land Management Asset Register & Associated Works			✓
Disabled Facilities - Discretionary	✓	✓	✓
Decent Home Grants	✓		✓
Colebrook Court (Network Housing)			✓
Community Capital Grants	✓	✓	✓