

Capital and Investment Strategy 2021/22 to 2023/24

1. Introduction

- 1.1 This Strategy gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services, along with an overview of how associated risk is managed and the implications for future financial sustainability.
- 1.2 This Strategy covers:
 - Governance arrangements for capital investment.
 - Capital expenditure forecasts and financing.
 - Prudential indicators relating to financial sustainability.
 - Minimum Revenue Provision (MRP) for the repayment of debt.
 - Treasury Management definition and governance arrangements.
 - Investments for service purposes, linked to the County Council's commercial strategy.
 - Knowledge and skills.
 - Chief Financial Officer's conclusion on the affordability and risk associated with the Capital and Investment Strategy.
 - Links to the statutory guidance and other information.

2. Governance

- 2.1 The County Council's Medium Term Financial Strategy (MTFS) ensures that we continue to invest wisely in our existing assets and deliver a programme of new ones in line with overall priorities and need. This is kept under review by the Corporate Infrastructure Group (CIG) which is chaired by the Director of Economy, Transport and Environment and includes representatives from his department, together with Officers from Children's Services, Adults' Health and Care, Property Services and the Head of Finance. The aim of the group is to ensure a co-ordinated approach to capital investment and major developments across the County Council.
- 2.2 In accordance with the MTFS, each year the Cabinet sets cash limit guidelines for a three year capital programme funded by local resources. Executive Members propose capital programmes within these cash limits together with schemes funded by government grants and other external sources. The proposed programmes are scrutinised by the relevant Select Committee. The final Capital Programme is then presented to Cabinet and to County Council in February each year as part of the formal budget approval.

3. Capital Expenditure and Financing

- 3.1 Capital expenditure is spending by the County Council on assets, such as land, property, the highway network or vehicles, that will be used for more than one year.

In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy or enhance assets.

- 3.2 The estimated level of capital expenditure (or 'payment') flows each year, together with forecasts of financing resources, are two of the factors considered in determining the size of the cash limit guidelines for the Capital Programme.
- 3.3 Capital expenditure may be funded directly from revenue, however the general pressures on the Council's revenue budget and council tax levels limit the extent to which this may be exercised as a source of capital funding. Prudential borrowing does provide an option for funding additional capital development but one which then results in costs that have to be funded each year from within the revenue budget or from generating additional ongoing income streams.
- 3.4 Given the pressure on the Council's revenue budget in future years, prudent use has been made of this discretion to progress schemes in cases where there was a clear financial benefit. Such schemes focus on clear priorities, and those that generate revenue benefits in future financial years, in the form of clear and measurable revenue savings or longer term income generation, either directly or through council tax or business rate yield.
- 3.5 Expenditure flows in 2020/21 and the following three years will result from works in progress (schemes started in 2020/21 and earlier years) plus those arising from the proposed programme for 2021/22 to 2023/24, as Table 1 below shows:

Table 1: Forecast Capital Expenditure Flows

	2020/21	2021/22	2022/23	2023/24
	£'000	£'000	£'000	£'000
Works in Progress at 31 March 2020 and Schemes starting in 2020/21	231,699	174,426	71,963	25,529
Programmes starting in 2021/22, 2022/23 and 2023/24	0	102,160	99,092	106,821
Land Acquisition	4,437	12,296	649	646
Total Expenditure Flows	236,136	288,882	171,704	132,996

- 3.6 In practice, expenditure flows in the years after 2020/21 may vary from those shown in Table 1 if further developer and other external contributions become available to fund additional capital schemes, or if the levels of government support differ from those currently assumed in the Capital Programme, which is presented in a separate report elsewhere on this Agenda.

Table 2 - Resources to Fund Capital Expenditure

	2020/21	2021/22	2022/23	2023/24
	£'000	£'000	£'000	£'000
Prudential borrowing	40,994	34,775	19,122	11,386
Less repayments from capital	(7,256)	(4,531)	(18,750)	(1,144)
Capital grants	139,699	174,565	85,117	75,331
Contributions from other bodies including developers	34,350	43,195	43,126	27,197
Capital receipts	92	4,128	14,319	0
Revenue contributions to capital	9,935	7,355	6,244	6,055
New Resources in the Year	217,814	259,487	149,288	118,825
Draw From / (Contribution to) the Capital Reserve:	18,322	29,395	22,416	14,171
Total Resources Available	236,136	288,882	171,704	132,996

4. Prudential Indicators

- 4.1 The framework for the use of prudential borrowing, as updated by Cabinet in February 2006, includes:
- Borrowing for which loan charges are financed by virement from the Executive Member's revenue budget, including invest-to-save schemes that will generate revenue savings or additional revenue income.
 - 'Bridging' finance that will be repaid by eventual capital receipts, capital grants or contributions, provided that the cost of interest and the statutory minimum revenue provision is met by services in the years that such costs are incurred.
 - Capital investment by business units, to be funded by business unit reserves.
 - Temporary borrowing to accommodate shortfalls in general capital resources.
- 4.2 As the loan repayments and interest charges must be financed by the County Council from its own resources, it is important that the use of prudential borrowing is very closely controlled and monitored.
- 4.3 The Council's cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR). In order to ensure that over the medium term debt will only be for a capital purpose, the County Council should ensure that debt does not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. This is a key indicator of prudence.

Table 3: Ensuring Borrowing is Only for Capital Purposes

	31/03/21 Revised £M	31/03/22 Estimate £M	31/03/23 Estimate £M	31/03/24 Estimate £M
CFR	800	805	774	752
Debt				
Borrowing	292	282	274	266
PFI Liabilities	141	133	124	115
Total Debt	433	415	398	381

4.4 Total debt is expected to remain below the CFR during the forecast period.

Affordable Borrowing Limit

4.5 The County Council is legally obliged to set an Authorised Limit for the maximum affordable amount of external debt. In line with statutory guidance, a lower 'Operational Boundary' is also set as a warning level should debt approach the limit. The Operational Boundary is based on the County Council's estimate of the most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the County Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring.

Table 4: Affordable Borrowing Limits

	2020/21 Revised £M	2021/22 Estimate £M	2022/23 Estimate £M	2023/24 Estimate £M
<i>Authorised Limit:</i>				
Borrowing	800	810	790	780
PFI and Leases	180	170	160	150
Authorised Limit	980	980	950	930
<i>Operational boundary:</i>				
Borrowing	730	740	720	710
PFI and Leases	150	140	130	120
Operational Boundary	880	880	850	830

Ratio of Financing Costs to Net Revenue Stream

4.6 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Table 5: Ratio of Financing Costs to Net Revenue Stream

	2020/21 Revised	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Ratio	2.5%	4.1%	4.7%	4.6%

- 4.7 A low proportion is forecast, demonstrating that the cost of financing is minimised and the proportion of the revenue budget available for delivering services is maximised.

Incremental Impact of Capital Investment Decisions

- 4.8 This is an indicator of affordability that shows the impact of capital investment decisions on council tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved Capital Programme and the revenue budget requirement arising from the Capital Programme proposed for the next three years.

Table 6: Incremental Impact of Capital Investment Decisions

	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
	£	£	£
General Fund - increase in Annual Band D Council Tax	1.51	3.90	1.45

5. Minimum Revenue Provision (MRP) for Debt Repayment

- 5.1 Where the County Council finances capital expenditure by debt, statutory guidance requires it to put aside revenue resources to repay that debt in later years, known as MRP. Statutory guidance requires the County Council to approve an Annual MRP Statement each year, and whilst it provides a range of options for the calculation of MRP, the guidance also notes that other options are permissible provided that they are fully consistent with the statutory duty to make prudent revenue provision.

MRP in 2021/22

- 5.2 Prior to 2015/16 the County Council calculated MRP for supported borrowing¹ on a 4% reducing balance basis. It was agreed by Cabinet in December 2015 that the calculation of MRP from 2015/16 onwards would change to a 50 year straight line basis. To be more prudent the 50 years has been started from 2008 and the actual calculation is 1/43's. Had the County Council been applying the new policy of a 50 year straight line calculation starting in 2008 it would have made £67m less in MRP payments by 31 March 2016.

¹ Borrowing or use other forms of credit to finance capital expenditure, for which central government previously provided a revenue stream to support repayment of principal and interest.

- 5.3 As agreed in 2016/17 the County Council has paused in making MRP payments on supported borrowing until it has realigned the total amount of MRP payments with the new policy, which will be during 2021/22. This policy continues the County Council's prudent approach of repaying expenditure financed by borrowing sooner, on a straight line basis.
- 5.4 The County Council will continue to apply the Asset Life or Depreciation Method (which are Options 3 and 4 from the range provided by the Guidance) in respect of unsupported capital expenditure funded from borrowing. Where the borrowing is in effect a bridging loan from a guaranteed future income source, such as Section 106 Developers Contributions, MRP will not be applied.
- 5.5 MRP in respect of leases and Private Finance Initiative (PFI) schemes brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.
- 5.6 Capital expenditure incurred during 2021/22 will not be subject to an MRP charge until 2022/23.
- 5.7 Based on the Authority's latest estimate of its CFR on 31 March 2021, the budget for MRP has been set as follows:

Table 7: MRP Budget

	31/03/2021 Estimated CFR £M	2021/22 Estimated MRP £M
Supported Capital Expenditure	455	6
Unsupported Capital Expenditure After 31/03/2008	177	10
Finance Leases and PFI	141	8
Transferred Debt	27	1
Total General Fund	800	25

6. Treasury Management

- 6.1 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.
- 6.2 The County Council has potentially large exposures to financial risks through its investment and borrowing activity, including the loss of invested funds and the effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's Treasury Management Strategy (TMS).

- 6.3 The County Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans, should the County Council's long-term plans change, is a secondary objective.
- 6.4 The County Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. It therefore invests its funds prudently and has regard to the security and liquidity of its investments before seeking the highest rate of return, or yield.
- 6.5 The County Council's TMS, included as Appendix 10, to this report is scrutinised by the Audit Committee and approved by the County Council each year. Actual performance is reviewed by the Audit Committee and reported to Cabinet and County Council.

7. Investments for Service Purposes

- 7.1 The County Council's Commercial Strategy was set out in the update of the MTFS presented to Cabinet and County Council in October and November 2019. A summary of the Strategy is outlined below.
- 7.2 There are four main areas where the County Council has sought to generate additional income to help close the budget deficit:
- Charging users for the direct provision of services.
 - Investing money or using assets to generate a return.
 - Expanding traded services to other organisations.
 - Developing Joint Ventures (JVs) that yield additional income or generate a return.
- 7.3 The second and fourth approaches listed above directly relate to this Capital and Investment Strategy, although it is the first and third approaches that contribute the most income on an annual basis to support the County Council's financial position. This is a deliberate outcome of the overall strategy and has been achieved through the pursuit of a range of initiatives targeting increased income generation but without overexposing the Council to excessive risk or considering radical changes that take the County Council into areas that are not its core business, or indeed pursuing more niche opportunities that simply do not offer with any confidence anything like the scale of income to merit the effort and upfront investment.

Pooled Funds

- 7.4 Faced with a historically low interest rate environment, the County Council decided, as part of the 2014/15 strategy, to earmark £90m of its cash balances for investments appropriately targeting a higher yield of around 4%. The County Council agreed to increase this amount to £200m in 2017 and to £235m in 2019 and a further increase to £250m is now proposed. This is in addition to £15m of long term investments that had been made for the Street Lighting PFI scheme. Higher yields can be accessed through investments in assets other than cash, such as equities,

bonds and property. The County Council has made investments in property, equity and multi-asset funds, as well as long term investments with other local authorities and as part of the Manydown programme.

- 7.5 The principal mitigation for risk is ensuring that investments in non-cash assets are held as long-term investments. This will enable the initial costs of any investment and any periods of falling capital values to be overcome. In order to be managed as long term investments, the amounts invested need to be taken from the County Council's most stable cash balances. The allocation of £250m has been based on a prudent assessment of the Council's investment balances and liquidity requirements.
- 7.6 The selection of investments to target higher yields is carefully managed with the assistance of Arlingclose, the County Council's treasury management advisor, who recommend that the County Council diversifies its investments targeting a higher return between asset classes. This is to mitigate the loss of capital value, so that there is no over exposure to an event that impacts the value of investments in a particular asset class, such as a fall in property prices.
- 7.7 The County Council utilises pooled investment vehicles as the most appropriate means to access asset classes such as property or equities. The County Council could build its own direct portfolios of these investments, such as property, however, its total allocation of £250m for a diversified portfolio would not enable this to be done efficiently and effectively with the appropriate risk mitigation. Pooled funds are managed by external specialist investment managers who are best placed to select the particular investments and then manage them, for example for property investments managing the relationship with tenants and maintenance of the building.

Utilising Property Assets

- 7.8 The County Council utilises its own property to make a return. In areas where we already own buildings we are working with partners to utilise this space more effectively from a joint service provision point of view and at the same time making a return on the space we have provided. Further work is being undertaken to maximise the usage of space in existing buildings with a view to potentially offering whole buildings on the commercial market for lease. This approach enables the County Council to use existing assets to generate income with minimal risk, compared to buying additional property using prudential borrowing purely to try to make a financial return.
- 7.9 In addition to property rationalisation, the County Council is also making more efficient use of its existing office space. Investment in new technology as part of the Enabling Productivity Programme together with improved fire safety measures have increased the capacity of the Castle complex. The strategy for office accommodation is currently under review in the light of changing ways of working, partly driven by the response to the coronavirus pandemic.

Developing Joint Ventures

- 7.10 There are a number of opportunities that the County Council can pursue either through its land holdings or through the relationships it has with partners or contractors that look at new and innovative ways of generating a financial return. To date the County Council has been helpful in responding to Borough Council Local

Planning Authority requests for the potential use of its public land holdings for potential residential development. This will continue the stream of substantial capital receipts the County Council has benefitted from over recent decades to enable it to reinvest in existing services and ongoing transformation initiatives.

- 7.11 In addition, an alternative avenue that the County Council is currently actively pursuing in two cases is to become even more active and influential in the market of delivering homes across the county on some of its key sites. This will have the benefit of not only giving greater influence and certainty in the types and rates of homes, neighbourhoods and infrastructure and facilities being developed on its land but also the potential for greater certainty in the programming of development and receipts through economic cycles. Furthermore, it will also offer the County Council the advantage of considering whether it wishes to benefit from capital or revenue receipts from development and residential assets or combinations of the two, depending on individual sites and its own circumstances.
- 7.12 The largest site is Manydown in Basingstoke and in May 2016 the County Council, along with joint landowner Basingstoke and Deane, secured the allocation of the initial Manydown Phase 1 development for up to 3,520 dwellings to be provided in the period up to 2029. Following public consultation that has enabled the finalisation of a development masterplan, planning approval is now being sought to take the site forward.
- 7.13 Another area that the County Council can look to exploit is the relationships it has with its partners and contractors. There is already a long standing relationship with our waste disposal contractors Veolia that includes innovative ways of generating income for both parties. The long term contract allows the use of surplus capacity at our waste facilities for commercial purposes for which the County Council receives an income share. Similarly, provisions are in place for working with our highways maintenance contractor Skanska to develop joint ventures linked to the existing contract that will yield additional income for both parties. A third example is the superfast broadband contract with BT Openreach that includes mechanisms that provide a rebate to the County Council when take up is greater than the original estimates in Openreach's commercial bid. To date, rebates and savings have added a further £6.3m of delivery to the programme without requiring additional capital funding from the County Council and further rebates are expected in the next few years.
- 7.14 With the primary aim of improving economic prosperity and related infrastructure within Hampshire, the County Council may consider granting loans to other organisations. To date, loans totalling £9.5m at market rates of interest have been approved to the Enterprise M3 Local Enterprise Partnership (EM3 LEP) and Farnborough International Ltd.
- 7.15 The development of all these opportunities is reported to Cabinet and, if additional capital schemes are proposed, County Council approval is sought to add them to the Capital Programme.

8. Knowledge and skills

- 8.1 The County Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions in accordance with the approved strategies. Performance

against targets and learning and development needs are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

- 8.2 Staff attend training courses, seminars and conferences provided by the Chartered Institute of Public Finance and Accountancy (CIPFA), Arlingclose and other providers. Relevant staff are also encouraged to study professional qualifications from CIPFA, and other appropriate organisations.
- 8.3 CIPFA's Code of Practice requires that the County Council ensures that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. All Members were invited to a workshop presented by Arlingclose in December 2020, which gave an update of treasury matters. A further Arlingclose workshop has been planned for 2021.

Investment Advisers

- 8.4 The County Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled through quarterly review meetings with the Deputy Chief Executive and Director of Corporate Resources, her staff and Arlingclose.

9. Chief Financial Officers Conclusion on the Affordability and Risk Associated with the Capital and Investment Strategy

- 9.1 This Capital and Investment Strategy has been developed alongside the TMS (Appendix 10) and the Reserves Strategy (Appendix 7). Together, they form an integrated approach adopted by the County Council to balance the need for capital investment to support service priorities with consideration of affordability and the consequent impact on the revenue budget, whilst recognising and managing risk to an acceptable level.
- 9.2 The forward planning of capital investment and its funding, including being in a position to maximise the use of external grants, contributions and capital receipts, together with the process of regular monitoring of actual income, expenditure, and project progress, provides assurance to the Deputy Chief Executive and Director of Corporate Resources that the proposed Capital Programme is prudent, affordable and sustainable.

10. Links to Statutory Guidance and Other Information

- 10.1 The Local Government Act 2003, Section 15(1) and the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146] require Local Authorities to have regard to the following guidance:
 - Ministry of Housing, Communities & Local Government (MHCLG) - Local Government Investment* [MHCLG Investment](#).
 - CIPFA's Prudential Code 2017
 - CIPFA's Treasury Management Code 2017

(*Where a local authority prepares a Capital Strategy in line with the requirements of the Prudential Code, and a TMS in line with the requirements of the Treasury Management Code, the Investment Strategy can be published in those documents instead of as a separate document).

- 10.2 The County Council includes its non-treasury management Investment Strategy within this Capital Strategy. The TMS is a separate document reported to Cabinet and County Council, (Appendix 10).
- 10.3 The proposed Capital Programme is a separate document presented to Cabinet and County Council in a separate report elsewhere on this Agenda.

Treasury Management Strategy Statement 2021/22 to 2023/24

1. Summary

- 1.1. The Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 (the CIPFA Code) requires authorities to determine their Treasury Management Strategy Statement (TMSS) before the start of each financial year.
- 1.2. This Strategy fulfils the County Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.
- 1.3. The purpose of this TMSS is, therefore, to present for approval the Treasury Management Strategy (including the Annual Investment Strategy) for 2021/22 to 2023/24; and the remainder of 2020/21

2. Introduction

- 2.1. In 2018 the Ministry of Housing, Communities & Local Government (MHCLG) produced new Investment Guidance including the requirement to produce an Investment Strategy. The County Council's Capital and Investment Strategy (Appendix 9) sets out the Council's broad approach to investment, including its capital programme, how this is funded, and investments held for service purposes or for commercial profit.
- 2.2. This Treasury Management Strategy (TMS) supports the Capital and Investment Strategy in setting out the arrangements for the management of the County Council's cash flows, borrowing and investments, and the associated risks.
- 2.3. The County Council has borrowed and invested sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the County Council's prudent financial management.
- 2.4. Treasury risk management at the County Council is conducted within the framework of the CIPFA Code which requires the County Council to approve a Treasury Management Strategy Statement (TMSS) before the start of each financial year. This Strategy fulfils the County Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.
- 2.5. Investments held for service purposes or for commercial profit are considered in the Capital and Investment Strategy (Appendix 9).

3. External Context

- 3.1. The following paragraphs explain the economic and financial background against which the TMS is being set.

Economic Background

- 3.2. The impact of the Covid-19 pandemic and the UK's exit from the European Union will continue to be a major influence on the County Council's TMS for 2021/22.

- 3.3. The Bank of England's (BoE) Monetary Policy Committee (MPC) met in December 2020 and voted unanimously to hold Bank Rate at 0.10% and to maintain its Quantitative Easing asset purchase programme at £895m. The MPC identified that the successful trialling of some Covid-19 vaccines was likely to reduce the downside risks to the economic outlook, but that economic activity had been affected by the increase in Covid-19 cases and reimposition of restrictions resulting in an unusually uncertain outlook for the economy, an outlook that will have been further affected by the subsequent national lockdown in January 2021.
- 3.4. Gross Domestic Product (GDP) grew by 16.0% in Quarter 3 after suffering a fall of 18.8% in the previous quarter, reflecting the easing of restrictions throughout the summer of 2020, although this had already slowed to 1.1% in September and 0.4% in October, leaving it 8% below its level in Quarter 4 of 2019.
- 3.5. UK Consumer Price Inflation (CPI) for November 2020 registered 0.3% year on year, down from 0.7% in the previous month and well below the BoE's target of 2%.
- 3.6. The most recent labour market data for the three months to October 2020 showed the unemployment rate was 4.9%, up 0.7% on the previous quarter. The government's employment support schemes may limit near term rises in unemployment, but the BoE predicts a substantial further increase is still likely. The employment rate fell to 72.5% in October and the three month average annual growth rate for wages was 2.1% for regular pay in real terms.

Credit Outlook

- 3.7. After spiking in late March 2020 due to the onset of the global pandemic, credit default swap (CDS) prices for the larger UK banks have steadily fallen back to almost pre-pandemic levels. Bank profitability in 2020 is likely to be significantly lower than in previous years as a result of significant provisions for potential losses resulting from the pandemic.
- 3.8. The credit ratings for many UK institutions were downgraded on the back of downgrades to the sovereign rating. Credit conditions more generally though in banks and building societies have tended to be relatively benign, despite the impact of the pandemic.
- 3.9. Looking forward there remains the potential risk for bank losses to be greater than expected when government and central bank support starts to be removed and Arlingclose therefore advises a cautious approach to bank deposits in 2021/22.

Interest Rate Forecast

- 3.10. The Council's treasury management adviser Arlingclose is forecasting that the Bank Rate will remain at 0.10% until at least the end of 2023. Downside risks remain, however, and may be heightened in the short term as the UK reacts to the escalation in coronavirus infection rates and the end of the Brexit transition period, therefore cuts to 0% or even into negative territory cannot be completely ruled out.
- 3.11. A more detailed economic and interest rate forecast provided by Arlingclose is attached at Annex A.

4. Balance Sheet Summary and Forecast

- 4.1. On 31 December 2020, the County Council held £306m of borrowing and £482m of investments. This is set out in further detail at Annex B. Forecast changes in these sums are shown in the balance sheet analysis in Table 1 below:

Table 1: Balance Sheet Summary and Forecast

	31/03/20 Actual £M	31/03/21 Estimate £M	31/03/22 Forecast £M	31/03/23 Forecast £M	31/03/24 Forecast £M
Capital Financing Requirement	783	800	805	774	752
Less: Other Long-term Liabilities					
- Street Lighting PFI	(100)	(96)	(91)	(86)	(81)
- Waste Management Contract	(49)	(46)	(42)	(38)	(34)
Borrowing CFR	634	658	672	650	637
Less: External Borrowing					
- Public Works Loan Board	(229)	(218)	(208)	(200)	(192)
- Other Loans (incl. LOBOs)	(45)	(41)	(41)	(41)	(41)
- Other Short-term Borrowing	(33)	(33)	(33)	(33)	(33)
Internal Borrowing	327	366	390	376	371
Less: Reserves and Balances	(643)	(641)	(647)	(615)	(615)
Less: Allowance for Working Capital	(227)	(79)	(154)	(230)	(230)
Resources for Investment	(870)	(720)	(801)	(845)	(845)
(Treasury Investments) / New Borrowing	(543)	(354)	(411)	(469)	(474)

- 4.2. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The County Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.
- 4.3. It is forecast that the County Council will continue to take advantage of internal borrowing, which will increase through until 2021/22, whilst paying off Public Works Loan Board (PWLB) debt as maturities arise.
- 4.4. Reserves and balances are forecast to reduce over the period due to the anticipated funding of the Capital Programme and use of the Budget Bridging Reserve (BBR) as part of the Council's Reserves Strategy as set out in Appendix 7. The County Council's investment balances are due to rise over the forecast period, however, as all employer's Local Government Pension Scheme (LGPS) pension contributions were paid early in April 2020 for the period to March 2023.

- 4.5. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the County Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the County Council expects to comply with this recommendation during 2021/22.

5. Borrowing Strategy

- 5.1. The County Council currently holds £305.6m of loans, including amounts held on behalf of others for governance or administrative purposes. The loans are predominantly as a result of the County Council's strategy for funding previous years' Capital Programmes. The balance sheet forecast in Table 1 shows that the County Council does not expect to need to take on new external borrowing in 2021/22. The County Council has the option to borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £980m, but does not currently expect to do so.

Objectives

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

Strategy

- 5.3. Given the significant cuts to public expenditure and in particular to local government funding, the County Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, the County Council expects to continue its approach of internally borrowing instead of taking on additional external borrowing.
- 5.4. By internally borrowing, the County Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. Arlingclose will assist the County Council in regularly monitoring the benefits of this approach against taking on short term external borrowing and the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly.
- 5.5. The County Council has previously raised the majority of its long-term borrowing from the PWLB. The County Council does not expect to take on any new long-term borrowing in 2021/22, however alternatives to the PWLB should the County Council need to borrow any long-term amounts include banks, pension funds and local authorities, as well as the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. A further alternative to internal borrowing would be for the County Council to use short term borrowing if necessary. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield however, the County Council intends to avoid this activity.

- 5.6. The County Council may also arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.
- 5.7. In addition, the County Council may borrow short-term loans (normally for up to one month) to cover unplanned cash flow shortages.

Sources

- 5.8. The approved sources of long-term and short-term borrowing are:
- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board).
 - Any institution approved for investments (see below).
 - Any other bank or building society authorised to operate in the UK.
 - Any other UK public sector body.
 - UK public and private sector pension funds (except Hampshire Pension Fund).
 - Capital market bond investors.
 - UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.

Other Sources of Debt Finance

- 5.9. In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:
- Leasing.
 - Hire purchase.
 - Private Finance Initiative (PFI).
 - Sale and leaseback.

LOBOs

- 5.10. The County Council holds £20m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the County Council has the option to either accept the new rate or to repay the loan at no additional cost.
- 5.11. All of these loans have options during 2021/22, and although the County Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The County Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so. Total borrowing via LOBO loans will be limited to the current level of £20m.

Short-term and Variable Rate Loans

- 5.12. These loans leave the Council exposed to the risk of short-term interest rate rises. This risk is monitored through the indicator on interest rate exposure in the treasury management indicators in this report.

Debt Rescheduling

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

6. Investment Strategy

- 6.1. The County Council holds invested funds representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the County Council's investment balance has ranged between £335m and £648m.
- 6.2. These balances have been lower than the County Council would typically hold due to the decision to pay employer's LGPS pension contributions in advance on 1 April 2020 for the three year period to March 2023 at a cost of approximately £225m. This payment was made without impacting liquidity and with the additional benefit of reducing counterparty risk.

Objectives

- 6.3. The CIPFA Code requires the County Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The County Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Negative Interest Rates

- 6.4. The Covid-19 pandemic has increased the risk that the BoE will set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options, and in some instances negative interest rates are already being seen. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy

- 6.5. Given the increasing risk and very low returns from short-term unsecured bank investments, the County Council aims to continue to be diversified in more secure and/or higher yielding asset classes during 2021/22. This is especially the case for the estimated £350m that is available for longer term investment.

- 6.6. Approximately 82% of the County Council's surplus cash at 31 December 2020 is invested so that it is not subject to bail-in risk, as it is invested in local authorities, secured bank bonds and pooled property, equity and multi-asset funds.
- 6.7. Of the 18% of cash that was subject to bail-in risk at 31 December 2020, 23% was held in very short-term notice accounts providing a comparatively favourable rate of interest in exchange for a short notice period within the 35-day maximum recommended by Arlingclose, 49% was held in overnight money market funds and cash plus funds which are subject to a reduced risk of bail-in, and 28% was held in overnight bank call accounts for liquidity purposes. This diversification is a continuation of the strategy adopted in 2015/16. Further detail is provided at Annex B.

Business Models

- 6.8. Under the new IFRS 9, the accounting for certain investments depends on the 'business model' for managing them. The County Council aims to achieve value from its internally managed treasury investments through a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

Investments Targeting Higher Returns

- 6.9. The County Council agreed in 2019 to increase the amount of its cash balances earmarked for investments targeting higher yields of around 4% to £235m. As set out in the Capital and Investment Strategy, it is now felt appropriate to increase this to £250m.
- 6.10. The CIPFA Code requires the County Council to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest yield. As a result, the County Council's investments targeting higher yields have been made from its most stable balances and with the intention that they will be held for at least the medium term. This means that the initial costs of any investment and any periods of falling capital values can be overcome and mitigates the risk of having to sell an asset for liquidity purposes, helping to ensure the long term security of the County Council's investments.
- 6.11. Higher yields can be targeted through longer term cash investments and by investing in asset classes other than cash. Following advice from Arlingclose, the County Council has constructed an investment portfolio that is diversified across asset classes and regions. This has been achieved by investing in pooled investment vehicles (pooled funds) alongside long term lending to other local authorities and loans relating to the Manydown development project. This diversification helps to mitigate the risk of overexposure to a single event affecting a specific asset class.
- 6.12. The use of pooled funds also enables the County Council to achieve a greater degree of diversification than could effectively be achieved by directly owning individual assets. Pooled funds are managed by specialist external fund managers who are best placed to select and manage investments, for example with property investments in selecting appropriate buildings and then managing the relationship with tenants and the maintenance of those buildings.

- 6.13. Diversification in itself does not guarantee positive outcomes. The selection of pooled funds is carefully managed to target funds with a strong performance track record and objectives that are well aligned to the County Council's aim of achieving income returns of around 4% per annum without putting its initial investment at undue risk over the longer term. The County Council is therefore currently invested in pooled funds that specialise in providing income returns to support the revenue budget. As a result of their income focus these funds may not achieve the same capital growth and therefore total return, as other more general investment funds, however they are likely to deliver significantly greater income returns than cash investments, particularly in the current interest rate environment.
- 6.14. The investible universe for pooled funds is vast and part of the service provided by Arlingclose as treasury advisors is to conduct research and suitable due diligence on pooled funds prior to making recommendations to their clients.
- 6.15. Past performance does not guarantee that funds can replicate successful outcomes in future and knowing which funds will perform well is not an exact science. The County Council will therefore continue to conduct its own ongoing review and scrutiny of the performance of its pooled fund investments. The County Council will also discuss these investments regularly with Arlingclose, who provide advice based on regular meetings with representatives from the pooled funds and their own ongoing due diligence on areas such as performance and investment style, strategy and process.
- 6.16. Just over £200m of the allocation to higher yielding investments has now been invested, with the remaining balance earmarked. The total amount invested includes £6m invested on behalf of the Thames Basin Heaths Joint Strategic Partnership Board (TBH JSPB), where the County Council acts as the administrative body. Any investments made from cash held on behalf of the TBH JSPB are made with the agreement that the TBH JSPB has received its own financial advice and assumes all risks associated with these investments.
- 6.17. The increase in the amount earmarked for higher yielding investments to £250m set out in the Capital and Investment Strategy will allow the County Council to continue to invest its investment balances appropriately and also to invest balances held on behalf of the TBH JPSB in line with their instructions.
- 6.18. The current portfolio of investments targeting higher yields is summarised in Table 2:

Table 2: Investments Targeting Higher Yields Portfolio

	Amount Invested (*)	Market Value at 31/12/2020	Gain / (Fall) in Capital Value
	£M	£M	%
Fixed Deposits	21.5	21.5	0.0
Pooled Property Funds	75.0	73.2	(2.4)
Pooled Equity Funds	50.0	47.0	(5.9)
Pooled Multi-Asset Funds	48.0	46.5	(3.2)
Total	194.5	188.2	(3.2)

* Excludes £6m invested in pooled funds on behalf of TBH JSPB

- 6.19. The County Council's investments in pooled funds bring significant benefits to the revenue budget, with over £25m of dividends earned since it first made these investments. Capital values have shown a strong recovery since the lows experienced in March 2020 as a result of the coronavirus pandemic and even though capital values remain below the amount originally invested, the dividends earned mean the total return is significantly positive. The total return for pooled funds since purchase was 14.31% at 31 December 2020.
- 6.20. At the current time, given the medium to long term nature of the investments, it is unlikely that a capital loss would ever be realised, since the County Council would avoid selling investments that realised a capital loss.
- 6.21. In addition to the risk of realising a capital loss, changes to IFRS 9 mean that capital gains and losses on investments need to be reflected in the revenue account on an annual basis, although there is currently a statutory override in place for local authorities that exempts them from complying with this requirement for the next three years.
- 6.22. When the County Council began to specifically target higher returns from a proportion of its investments, it also established an Investment Risk Reserve to mitigate the risk of an irrecoverable fall in the value of these investments. The balance held in this reserve is currently approximately £5m. This equates to about 2.5% of the amount invested, or 2.0% of the total earmark of £250m. The County Council intends to continue to contribute towards the Investment Risk Reserve when required to ensure 2.5% of the total amount invested is held in reserve (in line with the recommendation of 2.5% for the general fund balance).
- 6.23. In the short term the County Council continues to take a prudent approach to forecasting income returns from its investments targeting higher yields, anticipating lower percentage returns than in previous years, due to the ongoing impacts of the coronavirus pandemic on property rents, company dividends and other sources of income being sought by its pooled fund investment managers.
- 6.24. However, even if the target of 4% per annum is not delivered in the short term, the County Council expects to achieve significantly greater income returns from these investments than from the rest of its investment portfolio and has achieved an average income return of 4.51% per annum from its pooled fund investments since purchase. Table 3 provides an example of the difference in the annualised average income return from the higher yielding strategy at 31 December 2020 and the returns being achieved on the County Council's other investments at that date.

Table 3: Weighted Average Returns and Indicative Annualised Income

	Cash Balance 30/12/20 20 £M	Weighted Average Return %	Annualised Income £M
Short-term and Long-term Cash Investments	281.6	0.44	1.24
Investments Targeting Higher Yields	200.5	3.89	7.80
Total	482.1	1.88	9.04

- 6.25. The annualised average returns for pooled funds shown in Table 3 include the period prior to the coronavirus pandemic and the County Council is taking a more prudent approach when forecasting income returns for 2020/21. This is following advice from Arlingclose on the potential impact that the pandemic has had and will continue to have on the ability of pooled funds to deliver against their income targets in the short term. Any shortfall at the end of the year to the budgeted income will be met from the Covid-19 financial response package.

Investment Limits

- 6.26. The maximum that will be lent to any one organisation (other than the UK Government) will be £70m. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits are also placed on fund managers as shown in Table 4:

Table 4: Investment Limits

	Cash Limit
Any single organisation, except the UK Central Government	£70m each
UK Central Government	Unlimited
Any group of pooled funds under the same management	£175m per manager

Approved Counterparties

- 6.27. The County Council may invest its surplus funds with any of the counterparty types in Table 5 overleaf, subject to the limits shown:

Table 5: Sector and Counterparty Limits

Sector	Time Limit	Counterparty Limit	Sector Limit
The UK Government	30 years	Unlimited	N/A
Local authorities & other government entities	25 years	£70m	Unlimited
Secured investments *	25 years	£70m	Unlimited
Banks (unsecured) *	13 months	£35m	Unlimited
Building societies (unsecured) *	13 months	£35m	£70m
Registered providers (unsecured) *	5 years	£35m	£70m
Money market funds *	N/A	£70m	Unlimited
Strategic pooled funds	N/A	£70m	£350m
Real estate investment trusts	N/A	£35m	£70m
Other investments *	5 years	£35m	£70m

This table must be read in conjunction with the notes below

Minimum Credit Rating

- 6.28. Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant known factors including external advice will be taken into account.
- 6.29. For entities without published credit ratings, investments may be made where external advice indicates the entity to be of similar credit quality.

Government

- 6.30. Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 30 years.

Secured Investments

- 6.31. Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

Banks and Building Societies (Unsecured)

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

Registered Providers (Unsecured)

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

Money Market Funds

- 6.34. Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the County Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

Strategic Pooled Funds

- 6.35. Shares or units in diversified investment vehicles consisting of bond, equity and property investments. These funds offer enhanced returns over the longer term but are more volatile in the short term and allow the County Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. This sector also includes cash plus funds which are also a type of pooled fund, but are used for short-term funds, with a lower risk appetite. Because strategic pooled funds have no defined maturity date but are available for withdrawal after a notice period; their performance and continued suitability in meeting the County Council's investment objectives will be monitored regularly.

Real Estate Investment Trusts (REITs)

- 6.36. Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

Other Investments

- 6.37. This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the County Council's investment at risk.

Operational Bank Accounts

- 6.38. The County Council may incur operational exposures, for example through current accounts, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept low. The County Council's operational bank account is with National Westminster and aims to keep the overnight balances held in current accounts positive, and as close to zero as possible. The BoE has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the County Council maintaining operational continuity.

Risk Assessment and Credit Ratings

- 6.39. Credit ratings are obtained and monitored by the County Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
- no new investments will be made,
 - any existing investments that can be recalled or sold at no cost will be, and
 - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.
- 6.40. Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "negative watch") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other Information on the Security of Investments

- 6.41. The County Council understands that credit ratings are good but not perfect predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press and analysis and advice from the County Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.
- 6.42. When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the County Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the County Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt

Management Office, or invested in government treasury bills for example, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

Liquidity Management

- 6.43. The County Council has due regard for its future cash flows when determining the maximum period for which funds may prudently be committed. Historic cash flows are analysed in addition to significant future cash movements, such as payroll, grant income and council tax precept. Limits on long-term investments are set by reference to the County Council's medium term financial position (summarised in Table 1) and forecast short-term balances.
- 6.44. The County Council will spread its liquid cash over at least four providers (for example bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider, except in cases of extreme market stress whereby the County Council will be able to invest all of its liquid cash in one provider only, being the Debt Management Office.

7. Treasury Management Indicators

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

Interest Rate Exposures

- 7.2. The following indicator shows the sensitivity of the County Council's current investments and borrowing to a change in interest rates. Fixed rate investments maturing during the year are assumed to be variable for the remainder of the year.

Table 6: Interest Rate Risk Indicator

	31 December 2020	Impact of +/- 1% Interest Rate Change
	£M	£M
Sums Subject to Variable Interest Rates		
Investment	429.9	+ / - 4.3
Borrowing	20.0	+ / - 0.2

Maturity Structure of Borrowing

- 7.3. This indicator is set to control the County Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Table 7: Refinancing Rate Risk Indicator

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and within 20 years	75%	0%
20 years and within 30 years	75%	0%
30 years and above	100%	0%

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

Principal Sums Invested for Periods Longer Than a Year

- 7.5. The purpose of this indicator is to control the County Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Table 8: Price Risk Indicator

	2021/22	2022/23	2023/24
Limit on principal invested beyond year end	£350m	£330m	£300m

8. Related Matters

- 8.1. The CIPFA Code requires the County Council to include the following in its TMSS.

Financial Derivatives

- 8.2. Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (for example interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (for example LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).
- 8.3. The County Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the County Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

- 8.4. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit. The use of financial derivatives is not planned as part of the implementation of the TMSS and any changes to this would be reported to Members in the first instance.
- 8.5. In line with the CIPFA Code, the Authority will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

Investment Advisers

- 8.6. The County Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled through quarterly review meetings with the Deputy Chief Executive and Director of Corporate Resources, her staff and Arlingclose.

Markets in Financial Instruments Directive

- 8.7. The County Council has opted up to professional client status with its providers of financial services, including advisers, brokers, and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the County Council's treasury management activities, the Section 151 Officer believes this to be the most appropriate status

Annex A - Arlingclose Economic & Interest Rate Forecast December 2020

Underlying assumptions:

- The medium-term global economic outlook has improved with the distribution of vaccines, but the recent upsurge in coronavirus cases has worsened economic prospects over the short term.
- Restrictive measures and further lockdowns are likely to continue in the UK and Europe until the majority of the population is vaccinated by the second half of 2021. The recovery period will be strong thereafter, but potentially longer than previously envisaged.
- Signs of a slowing UK economic recovery were already evident in UK monthly GDP and PMI data, even before the second lockdown and Tier 4 restrictions. Employment is falling despite an extension to support packages.
- The need to support economic recoveries and use up spare capacity will result in central banks maintaining low interest rates for the medium term.
- Brexit will weigh on UK activity. The combined effect of Brexit and the after-effects of the pandemic will dampen growth relative to peers, maintain spare capacity and limit domestically generated inflation. The Bank of England will therefore maintain loose monetary conditions for the foreseeable future.
- Longer term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid longer-term inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or the deployment of vaccines.

Forecast:

- Arlingclose expects Bank Rate to remain at the current 0.10% level.
- Our central case for Bank Rate is no change, but further cuts to zero, or perhaps even into negative territory, cannot be completely ruled out.
- Gilt yields will remain low in the medium term. Shorter term gilt yields are currently negative and will remain around zero or below until either the Bank expressly rules out negative Bank Rate or growth/inflation prospects improve.
- Downside risks remain, and indeed appear heightened, in the near term, as the government reacts to the escalation in infection rates and the Brexit transition period ends.

	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Official Bank Rate													
Upside risk	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Artinclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-month money market r.													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Artinclose Central Case	0.10	0.10	0.15	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
1yr money market rate													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Artinclose Central Case	0.15	0.15	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Downside risk	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
5yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Artinclose Central Case	0.00	0.00	0.05	0.10	0.15	0.20	0.20	0.20	0.25	0.25	0.25	0.25	0.25
Downside risk	0.40	0.45	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60
10yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Artinclose Central Case	0.25	0.30	0.35	0.35	0.40	0.40	0.45	0.45	0.50	0.55	0.55	0.55	0.60
Downside risk	0.50	0.50	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55
20yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Artinclose Central Case	0.70	0.70	0.75	0.75	0.75	0.80	0.80	0.85	0.85	0.85	0.85	0.90	0.90
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
50yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Artinclose Central Case	0.60	0.60	0.65	0.65	0.65	0.70	0.70	0.75	0.75	0.75	0.75	0.80	0.80
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%

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

Annex B - Existing Investment & Debt Portfolio Position at 31 December 2020

Investment Position (Treasury Investments)

<u>Investments</u>	Balance 30/09/2020 £M	Movement £M	Balance 31/12/2020 £M	Rate 30/12/2020 %	WAM (*) 31/12/2020 Years
Short Term Investments					
- Banks and Building Societies:					
- Unsecured	23.5	21.7	45.2	0.03	0.0
- Money Market Funds	58.6	(25.8)	32.8	0.01	0.0
- Local Authorities	105.0	28.0	133.0	0.41	0.6
- Cash Plus Funds	10.0	0.0	10.0	1.23	0.0
	197.1	23.9	221.0	0.31	0.4
Long Term Investments					
- Banks and Building Societies:					
- Secured	30.6	0.1	30.7	0.35	1.7
- Local Authorities	25.0	4.9	29.9	1.51	1.3
	55.6	5.0	60.6	0.92	1.5
Long Term Investments – high yielding strategy					
- Local Authorities	21.5	0.0	21.5	4.31	12.8
- Pooled Funds					
- Pooled property**	77.0	0.0	77.0	3.51	N/A
- Pooled equity**	52.0	0.0	52.0	4.46	N/A
- Pooled multi-asset**	46.0	4.0	50.0	3.69	N/A
	196.5	4.0	200.5	3.89	12.8
Total Investments	449.2	32.9	482.1	1.88	1.1

* WAM - Weighted Average Maturity

** The rates provided for pooled fund investments are reflective of the average dividend return over the last 12 months.

	Balance 31/12/2020	Average Rate 31/12/2020
	£M	%
<i>External Borrowing</i>		
PWLB Fixed Rate	(223.5)	(4.73)
Other Loans (including LOBO Loans)	(41.3)	(4.34)
Other Short-term Borrowing (*)	(40.8)	N/A
Total External Borrowing	(305.6)	(4.67)
<i>Other Long-Term Liabilities:</i>		
Street Lighting PFI	(95.6)	
Waste Management Contract	(45.9)	
Total Other Long-Term Liabilities	(141.5)	
Total Gross External Debt	(447.1)	
Investments	482.1	1.88
Net (Debt) / Investments	35.0	

* Includes balances held by the County Council on behalf of others for governance or administrative reasons.