MIDDLESBROUGH COUNCIL

Report of:	Director of Finance – Ian Wright

Submitted to:	Corporate Affairs & Audit Committee – 4 March 2021

Subject:	Capital Strategy – 2021/22

Summary

Proposed decision(s)
For Members of the Committee to note the key elements of the Council's capital strategy and to understand how the prudential indicators and treasury strategies ensure that this is affordable & sustainable over the medium term.

Report for:	**Key decision:**	**Confidential:**	**Is the report urgent?**[1]
Discussion	*No*	*No*	*No*

Contribution to delivery of the 2020-23 Strategic Plan		
People	**Place**	**Business**
Not Applicable	Not Applicable	The Capital strategy is a best practice requirement that supports the Council's medium term financial plan. There are a number of statutory matters covered by the Strategy which need approval before the start of each financial year.

Ward(s) affected
No direct impact on any wards.

What is the purpose of this report?

1. The Capital Strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activities contribute to the provision of local public services at the Council. In addition, it also gives an overview of how the associated risks are managed and the implications for future financial sustainability.

2. The report is an Appendix to the Revenue Budget & Medium Term Financial Plan report being considered by Council on 24th February. The two CIPFA codes that cover this area – the prudential code on capital finance and the treasury management code of practice for local authorities – both recommend that the capital strategy is independently scrutinised by a local authority committee outside the budget approval process. This encourages challenge, transparency and financial probity on these matters, as well as a best practice approach. Given its wider governance responsibilities, this Committee is best placed to undertake this role.

Why does this report require a Member decision?

3. This report is for information and discussion by the Committee. No formal decisions are required.

Report Background

4. The capital strategy report for the Council covers the following areas:

- How the Investment Strategy is funded;
- The relevant prudential Indicators to monitor the performance, affordability and sustainability of the capital expenditure being proposed in line with the requirements of the prudential code;
- Treasury Management arrangements in place for investing surplus funds and borrowing to fund capital expenditure;
- The types of investments the Council makes as part of managing its cash balances – the Annual Investment Strategy;
- Knowledge and skills of staff involved in the Treasury Management process;
- Minimum Revenue Provision policy – including outlining how much the Council sets aside to re-pay debt built up to fund prior year's capital expenditure in the Borough.

5. Capital Expenditure relates to what the Council plans to invest in long-term assets and infrastructure (such as property, equipment, vehicles, roads etc.). The Council has to consider how this expenditure is paid for and what the long-term financial implications are of undertaking this investment. The Council is also permitted to borrow funds to finance the investment strategy under the Local Government Act 2003. It needs to consider the impact on the revenue budget of the level of borrowing being proposed, how it funds the repayment of this debt and the period over which this debt is repaid.

6. The Council must ensure the investment strategy is also prudent and affordable. Where elements of the Capital Plan are funded by borrowing (either externally or internally), the Council must set aside budgetary allocations in the revenue budget to repay this debt. These budgets include the interest payable to lenders on external borrowing and the setting aside of funds to re-pay the principal element of debt (known as the Minimum Revenue Provision).

Prudential Indicators and Capital Investment Plans

7. The Council demonstrates the concepts of affordability, sustainability and prudence on its investment plans by setting a range of Prudential and Treasury Management indicators. These are set out in the various tables in Appendix 1 and are key metrics to the Director of Finance when setting the budget plans each year. Any breach of these indicators during a year indicates either a higher level of indebtedness or a lower level of prudence on the capital activities of the Council than when the budget was set. The following paragraphs give a brief commentary on these key indicators

8. There is total outstanding debt of £223.900 million (including debt and lease liabilities) at 31 January 2021, with a further £10 million expected before 31st March 2021. Cash balances have been higher than normal during this financial year due to front loading of grants by government in relation to the Covid-19 response.

9. The forecast overall total long term external debt at the end of 2020/21 of £233.900 million should be compared with the estimated *Capital Financing Requirement* (the underlying value which the Council needs to borrow to fund capital activities) of £246.287 million. The Council therefore has an under-borrowed position of £22.387million, which provides some savings in interest payments as other revenue and capital cash has been used in lieu of borrowing. This is a key strategic decision each year as to whether the under-borrowing position is increased or reduced.

10. Table 6 in Appendix 1 shows the profile of outstanding debt over the whole of the medium term financial planning period and this will rise to a maximum of £258.000 million at 31st March 2023 before starting to reduce in the following financial year. This increase in debt is a direct result of the amount required to fund the investment strategy in each year.

11. The Council holds revenue budgets for repaying debt (known as Capital Financing Costs). The repayment of debt costs for 2020/21 are £9.542 million (8.2% of the net revenue budget for 2020/21). For comparison purposes the forecast capital financing costs in 2021/22 are expected to be £9.689 million (which represents 8.3% of the planned net revenue budget for 2021/22).

12. Table 9 in Appendix 1 shows that the proportion of capital financing costs is relatively stable at a time when the level of external debt is rising. This is due to the commercial income achieved on recent capital investments in Centre Square, Teesside Advanced Manufacturing Park and Captain Cook Square. It is important that these income levels are maintained otherwise the proportion of the revenue budget attributed to capital financing costs will start to increase.

13. It is also a statutory requirement for the Council to set an authorised limit for external debt at the start of each financial year. This is an amount beyond which it would be ultra-vires (or outside of its powers) to exceed in a particular financial year. The authorised limit for 2020/21 is £300.000 million with this being increased to £315.000 million for 2021/22 due to an increase in the level of borrowing needed for the investment strategy.

14. It should be noted that the authorised limit for the Council is currently much higher than either the level of external debt or the capital financing requirement. This is not uncommon within local authorities to build in extra headroom for unexpected capital investment, possible debt re-financing opportunities and the remote possibility of needing to borrow for exceptional revenue purposes. At present, the Council's authorised limit is set at £60m above its capital financing requirement and allows a degree of flexibility within the Council's planning processes and this legal limit. It should be noted that any unexpected debt financing in a year could breach some of the other prudential indicators so this would be identified as part of the quarterly performance monitoring reports to Executive.

Treasury Management

15. Treasury Management is defined as the management of the Council's cash flows, borrowing and investments, and the associated risks. The main risks that affect a local authority include credit risk, interest rate risk, liquidity risk and refinancing risk.

16. The Council is generally cash rich in the short term as many grants and contributions are paid in advance of need. As a result of this any excess cash is invested with an appropriate counterparty until the funds are required. When making an investment, the Council follows the advice set out in the Local Government Act 2003 and within the Treasury Management Code with paramount consideration given to the security of the sum invested, followed by the liquidity position of the Council and finally the interest rate achievable on the investment.

17. Given that credit criteria is the most important factor when making an investment decision, the Council receives regular updates from its external adviser, Arlingclose, on changes in credit ratings for individual financial institutions. They also advise on maximum amounts to be invested with each counterparty and maximum durations for any fixed term deposits made. This framework helps to protect against the loss of any sums invested (credit risk), ensures liquidity is not compromised and earns interest to support the revenue budget (not a major factor at present).

18. At 31st January 2021, the Council had cash balances of £20.800 million invested either on fixed term deposit with central government or in liquidity accounts with appropriate banks. The strategic level of cash holdings is a minimum of £15.000 million below which the Council will look to borrow to maintain liquidity.

19. In relation to external borrowing, the Council seeks to achieve a low but fairly certain cost of finance, whilst retaining the flexibility to borrow for short-term periods and to respond to demands of the Investment Strategy as needed. The Council therefore creates a balance between taking advantage of currently low rates of interest for short term borrowing (predominantly from other local authorities) versus the need to achieve certainty over rates of borrowing in the longer term from either government or financial institutions (mainly from the PWLB or other banks).

20. Out of the £223.900 million worth of external debt at 31st January 2021, 69% is long term from the Public Works Loan Board – the government agency for local authority borrowing and 31% is long term with financial institutions (generally banks). There is no short term borrowing in place at present. The average interest rate on this debt is around 2.5% with an average life to maturity of just under 25 years.

21. Current long term interest rates for borrowing from the PWLB are between 1% and 2.5% depending on the length of the loan (local authorities can borrow up to 50 years from central government) with short term rates being between 0.05% and 0.2% for up to one year in duration.

22. On local authority borrowing, there has been much interest from both regulators and the media in recent months around individual councils taking significant amounts of long term debt from the PWLB for the sole purposes of commercial activity – generally property investment. Under the Prudential Code, local authorities have lots of freedom to conduct and self-regulate their own borrowing and investment activities.

23. Both the Government and the Chartered Institute of Public Finance & Accountancy have said that borrowing for the sole purposes of commercial investment is against the spirit of the Code. The PWLB has outlawed any local authority applications for this type of activity from 1st April 2021 with Section 151 Officers having to confirm each year that their investment plans do not contain any of these types of activity. CIPFA is also updating the Prudential Code during 2021/22 to stop any borrowing for yield purposes.

24. Although the Council has undertaken some capital projects in recent years that have generated a revenue income stream as set out in paragraph 12 above, the primary aim has always been to regenerate the areas involved and to grow the wider economy within the Town. As a result, these activities would be able to continue under the Code and with funding from the PWLB if required.

Knowledge & Skills

25. The Capital Strategy provide details of the knowledge and experience in place by Officers and the access to external advice and guidance made available to enhance this. Council officers have a broad range of skills to ensure treasury management decisions are informed and risk-assessed on a consistent basis. The Council uses external consultants including Arlingclose to provide up to date and specialist advice which is bespoke for local government sector regulations, particularly focusing on risks and opportunities.

26. The Council also participates in a treasury management benchmarking club run by Arlingclose. This club provides access to data on other local authorities' approaches to Treasury Management, including strategic information, and the wider performance outputs of the Treasury Management activities.

27. As part of the Treasury Management Code, it is also a best practice requirement that elected members have the necessary skills & knowledge to scrutinise the Council's plans and processes in this area. Part of this will be achieved by bringing this report for discussion on an annual basis. In addition to this, it is intended to provide Members with further training on the capital and treasury strategies of the Council.

Minimum Revenue Provision

28. The Council is required to maintain a policy for the repayment of debt incurred over previous years. The policy is split into different elements which are influenced by when the borrowing was originally incurred, the type of assets and the useful economic life of the assets the borrowing is funding. The Council has in previous

years amended this policy to more accurately reflect the useful economic life of the funded assets. No changes are proposed to the MRP policy for 2021/22. This policy is set out at the end of Appendix 1.

What decision(s) are being asked for?

29. Although there is no formal decision to be made, Members should endorse the inclusion within the Terms of Reference for the Committee of the governance and scrutiny of the capital strategy going forwards.

Why is this being recommended?

30. No recommendations are being proposed.

Other potential decisions and why these have not been recommended

31. Not applicable

Impact(s) of recommended decision(s)

32. Although the report does not contain any recommendations, it will affect the workload and potentially the terms of reference of the Committee in the future. As a result, the update is mainly for information and discussion.

Legal

33. There are no direct legal implications of this report. All activity on capital financing, investments and borrowing is under current local authority powers under either the local government act or the capital finance and accounting regulations.

Financial

34. All relevant financial implications are outlined within the body of this report.

Policy Framework

35. There are no implications for the policy framework of the Council.

Equality and Diversity

36. There are no equality and diversity issues as part of this report.

Risk

37. Any risk related issues are set out within the report. Risk management is an integral part of the Council's treasury management strategy and these are considered as part of business as usual activities.

Actions to be taken to implement the decision(s)

38. Not applicable to this report.

Appendices

Appendix 1 – Capital Strategy report for 2021/22 (This is appendix 6 to the current revenue budget, MTFP, investment strategy and capital strategy report being considered by Council as part of the budget setting process on 24th February 2021).

Background papers

There are no background papers to this report.

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APPENDIX 1

CAPITAL STRATEGY REPORT 2021/22

Introduction

The Capital Strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activities contribute to the provision of local public services at the Council. In addition, it also gives an overview of how the associated risks are managed and the implications for future financial sustainability.

The report is a requirement of the 2017 Code of Practice on Treasury Management, issued by the Chartered Institute of Public Finance & Accountancy, and has been produced in an accessible way to enhance members' understanding of these often-technical areas. It is a replacement for the prudential indicator and treasury management report included within previous budget setting reports prior to 2019/20, but gives a wider context on the capital financing processes used by the Council.

Capital Expenditure and Financing

Capital Expenditure is where the Council spends money on assets, such as property, IT and vehicles that will be used for more than one financial year. In local government, this also includes spending on assets owned by other bodies, finance leases and loans & grants to other bodies enabling them to buy assets. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below £10,000 are generally not capitalised.

- For details of the Council's policy on the capitalisation of assets, see the accounting policies section of the annual statement of accounts on the Council's website (www.middlesbrough.gov.uk).

In the 2021/22 financial year, the Council is planning a total capital expenditure of £63.338m as summarised below:

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

	2019/20 **£000** **Actual**	**2020/21** **£000** **Estimate**	**2021/22** **£000** **Estimate**	**2022/23** **£000** **Estimate**	**2023/24** **£000** **Estimate**
Total Capital Expenditure – Investment Strategy	47.343	45.195	59.838	31.070	8.477
Total Capital Expenditure – Finance Leases	12.374	0.000	3.500	0.500	0.500
Total Capital Expenditure	**59.717**	**45.195**	**63.338**	**31.570**	**8.977**

The main areas of capital expenditure to be undertaken by the Council in 2021/22 include the new BOHO 10 scheme - £11.4m, Middlesbrough Development Company projects - £12.2m, Affordable Housing & Housing Growth schemes - £3.4m, Town Centre development projects £1.8m, School capital projects £11.7m, Disabled Facilities Grant schemes £2.7m, ICT related projects £3.6m, and Environment & Commercial Services projects £6.5m.

Governance: Service managers generally bid during the previous financial year to include projects in the Council's forward capital programme. Bids are collated by the Council's finance team who calculate the financing costs of each project (which can be nil if the project is fully externally financed). The Council's Management Team (CMT) appraises all bids based on a comparison of service priorities against financing costs and then makes recommendations to Members for which schemes progress against the capital resources available. The final capital programme to support the Medium Term Financial Plan is then presented to Executive during February and to Council in March each year for approval.

All capital expenditure has to be financed, from either external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and private finance initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £ millions

	2019/20 actual	**2020/21 forecast**	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**
External sources	17.860	20.221	31.537	13.547	0.048
Own resources	2.038	6.425	14.811	5.951	8.273
Debt	39.819	18.549	16.990	12.072	0.656
TOTAL	**59.717**	**45.195**	**63.338**	**31.570**	**8.977**

Any external debt (loans and leases) must be repaid over time by other sources of finance. This comes from the revenue budget in the form of Minimum Revenue Provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace/repay debt finance. The Council generally uses capital receipts to finance new capital expenditure rather than to redeem debt. The total cost of MRP included in the Council's revenue budget is as follows:

Table 3: Minimum Revenue Provision in £ millions

	2019/20 actual	**2020/21 forecast**	**2021/22 budget**	**2022/23 budget**	**2023/24 budget**
Cost to Revenue Budget	3.440	4.743	5.013	5.306	5.764

- The Council's minimum revenue provision statement for 2021/22 is available towards the end of this report.

The Council's cumulative amount of debt finance still outstanding is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure each year and then reduces with minimum revenue provision and capital receipts used to redeem debt.

The CFR is expected to increase by £8.9m or 3.6% during the 2021/22 financial year. This increase is due to the new capital expenditure funded by external debt of £17m less the MRP set aside of £5.0, plus other income streams of £3.1m.

Based on the above plans for expenditure and financing, the Council's estimated CFR for the period of the Medium Term Financial Plan is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

	31.3.2020 actual	31.3.2021 forecast	31.3.2022 budget	31.3.2023 budget	31.3.2024 budget
TOTAL CFR	**232.481**	**246.287**	**255.164**	**261.630**	**256.223**

Asset disposals: When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or be used to repay debt. The Council is currently also permitted to spend capital receipts on service transformation projects until 2021/22. Repayments of capital grants, loans and investments also generate capital receipts.

The Council plans to receive £14.6m of capital receipts in the coming financial year as follows:

Table 5: Capital receipts in £ millions

	2019/20 actual	2020/21 forecast	2021/22 budget	2022/23 budget	2023/24 budget
TOTAL	**1.968**	**5.358**	**14.597**	**5.951**	**8.273**

- The level of capital receipts for each financial year is monitored between Regeneration, Finance and Valuation & Estates teams, and any significant changes are reported to Executive as part of the Quarterly budget updates.
- The Council has not adopted the Flexible Use of Capital Receipts Policy where these proceeds may be used for funding service transformation costs that would otherwise be classed as revenue expenditure

Treasury Management

Treasury Management is concerned with keeping sufficient but not excessive cash resources, available to meet the Council's spending needs, while managing the risks involved in these investments. Surplus cash is invested until required, whilst a shortage of cash will be financed 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 and before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. Revenue cash surpluses are therefore offset against capital cash shortfalls to reduce the overall borrowing amount required, as part of an integrated strategy on Treasury Management. This is in line with best practice.

The Council at the end of January 2021 had £223.9m of borrowing at an average interest rate of 2.5% and £20.8m of treasury investments at an average rate of around 0.1%.

Both investment and borrowing rates available to the Council continue to be at historic lows due to ongoing government policy plus also the impact of the current coronavirus pandemic. There is an outside chance that the UK could see a negative bank rate in the 2021/22 financial year for the first time in its history.

Borrowing strategy: The Council's main objectives when borrowing are to achieve a low but certain cost of finance for long-term capital projects whilst retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between using cheap short-term loans (currently available at variable rates between 0.05% & 0.5%) and long-term fixed rate loans where the future cost is known but interest costs are higher (currently between 1% to 2.5%). In recent years, the Council has also been in negotiation with funders around lease arrangements as an alternative method of securing external finance for its capital projects.

Projected levels of the Council's total outstanding debt (which comprises borrowing and relevant finance leases) are shown below, compared with its capital financing requirement (need to borrow)

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

	31.3.2020 actual	31.3.2021 forecast	31.3.2022 budget	31.3.2023 budget	31.3.2024 budget
External Debt	242.900	233.900	**248.100**	258.000	252.600
Capital Financing Requirement	232.481	246.287	**255.164**	261.630	256.223

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term where the benefits of short term borrowing may be taken. As can be seen from Table 6, the Council expects to comply with this in the medium term with debt being lower than the capital financing requirement in all relevant financial years. The only exception to this being at the end of the 2019/20 financial year where £20m of additional borrowing was taken for grants to business and general liquidity purposes as a result of the Council's initial response toCovid-19. This funding was quickly reimbursed by Government and the short term debt borrowed was repaid during April 2020.

Affordable borrowing limit: The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt levels start to approach the legal limit and is a more realistic rather than worst-case view of what will happen during the financial year. Any need to change these during the 2021/22 financial year from the original budget assumptions will be reported by the Director of Finance to the Executive at the earliest opportunity.

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

	2020/21 limit	**2021/22 limit**	**2022/23 limit**	**2023/24 limit**
Authorised Limit (OB + £30m)	300.000	**315.000**	322.000	316.000
Operational Boundary (CFR + £30m)	280.000	**285.000**	292.000	286.000

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

The Council's policy on treasury investments is to prioritise security and liquidity over yield, which focuses on minimising risk rather than maximising returns. Cash that is likely to be spent in the short term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss.

Table 8: Treasury management investments in £millions

	31.3.2020 actual	**31.3.2021 forecast**	**31.3.2022 budget**	**31.3.2023 budget**	**31.3.2024 budget**
Short-term investments	43.863	15.268	17.228	15.000	15.000
Longer-term investments	0.000	0.000	0.000	0.000	0.000
TOTAL	**43.863**	**15.268**	**17.228**	**15.000**	**15.000**

Governance: Decisions on treasury management in relation to investment and borrowing are made daily and are therefore delegated by the Director of Finance to the Head of Finance & Investments and staff within the financial governance team, who act in line with the treasury management strategy approved by Council. Quarterly updates on treasury management activity are reported to Executive as part of the regular budget monitoring process.

Revenue Budget Implications

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to the revenue budget, offset by any investment income received. The net annual charge is reported as capital financing costs; this is compared to the net revenue stream i.e. the amount funded from council tax, business rates and general government grants. This is an important indicator around the affordability of the Council's capital plans going forwards.

Table 9: Prudential Indicator: Proportion of financing costs to net revenue stream

	2019/20 actual	**2020/21 forecast**	**2021/22 forecast**	**2022/23 forecast**	**2023/24 forecast**
Financing costs (£m)	8.857	9.542	**9.689**	9.965	10.285
Net Revenue Budget (£m)	111.926	116.397	**116.492**	118.399	120.343
Proportion of net revenue stream	7.9%	8.2%	**8.3%**	8.4%	8.5%

Sustainability: Due to the very long-term nature of capital expenditure and its financing, the revenue budget implications of this expenditure incurred in the next few years could extend for up to some 50 years into the future.

The figures in table above remain relatively stable at a time when debt levels for the Council are still increasing. Members should be aware that this is as a result of various capital investments in commercial property made by the Council during 2019/20 and 2020/21 for regeneration purposes. This results in around £3.1m of income per year being credited to the capital financing budget by the end of the 2023/24 financial year. It is imperative and a key budget risk that these rental levels are maintained and the income assumed in the estimates above are generated. Progress will be reported as part of future budget monitoring and performance reports each quarter to Executive. The forecasts above may also differ slightly from the total included in the revenue budget for 2021/22 due to timing.

The Director of Finance is satisfied that the proposed capital programme is prudent, affordable and sustainable because appropriate resources have been allocated from the Council's medium term financial plan, any finance leases have been appropriately vetted and any borrowing plans have been fully costed and reviewed.

Table 10 – Total Borrowing required for each year of the MTFP

	2020/21 £000 Estimate	2021/22 £000 Estimate	2022/23 £000 Estimate	2023/24 £000 Estimate
Investment Strategy	18,549	16,490	10,572	156
Finance Leases	0	500	500	500
Debt Restructuring	0	0	0	0
Total	18,549	16,990	11,072	656

This takes into account any debt needed by the Council to either finance the capital programme, in respect of leasing arrangements, or to finance any debt restructuring required.

Current interest rates at present (with historical lows) mean that this is not possible for the next three financial years and therefore no amounts have been factored into the borrowing plans of the Council for this. If this situation changes, this will be reported to Executive at the earliest opportunity.

The prudential indicators & limits set out in this report are consistent with the Council's current commitments, existing plans and the proposals in the budget report for capital expenditure and financing, and with its approved treasury management policy statement and practices.

The Director of Finance confirms that these are based on estimates of the most likely and prudent scenarios, with in addition sufficient headroom over and above this to allow for operational management and some scope for flexibility. For example unusual cash movements or any unbudgeted capital expenditure required. Risk analysis and management strategies have been taken into account; as have plans for capital expenditure, estimates of the capital financing requirement and estimates of cash flow requirements for all purposes.

Prudence – Treasury Management Indicators

It is recommended that the Council sets an upper limit on its fixed interest rate exposures for 2021/22, 2022/23 and 2023/24 of 100% of its estimated total borrowing undertaken.

It is further recommended that the Council sets an upper limit on its variable interest rate exposures for 2021/22, 2022/23 and 2023/24 of 25% of its estimated total borrowing undertaken.

This means that the Director of Finance will manage fixed interest rate exposures on total debt within the range 75% to 100% and variable interest rate exposures on total debt within the range 0% to 25%.

It is also recommended that the Council sets upper and lower limits for the maturity structure (when the debt needs to be repaid) of its total borrowing as follows.

<u>Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate at the start of the period:</u>

	Upper limit	**Lower limit**
under 12 months	50%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	90%	20%

Currently investments are limited to a maximum of 3 years, with any deals being arranged so that the maturity will be no more than 3 years and one month after the date the deal is arranged.

The maximum % of the total of all investments that have an outstanding period of one year or longer, at the time the investment is made, is 10%.

Knowledge and Skills

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Head of Finance and Investments has in excess of 20 years' experience in local government treasury management. There is similar experience within the finance teams in relation to budgeting & accounting for capital expenditure and financing. The Council also pays junior staff to study towards relevant professional qualifications including CIPFA, CIMA, ACCA, AAT and other relevant vocational studies.

Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

- Further details on staff training and the policy on the use of external advisers can be seen with reference to its Treasury Management Practices document which is on the Council's website.

Treasury Management Practices

Further details of how the treasury management function operates, the procedures used to manage banking, treasury and capital market transactions, how risk is managed by the in-house team and how this fits with the CIPFA Code of Practice is included in the Council's set of Treasury Management Practices.

This document is available to Members for further information on request.

ANNUAL INVESTMENT STRATEGY & TREASURY

MANAGEMENT POLICY STATEMENT 2021/22

1. In accordance with revised guidance from the Ministry of Housing, Communities and Local Government (MHCLG) a local authority must prepare and publish an Annual Investment Strategy which must be approved by full Council before the start of the financial year to which it relates.

2. The MHCLG guidance offers councils greater freedom in the way in which they invests monies, providing that prior approval is received from Members by approving the Annual Investment Strategy. The guidance also considers the wider implications of investments made for non-financial returns and how these can be evaluated.

3. The Local Government Act 2003, which also introduced the Prudential Code, requires that a local authority must have regard to such guidance as the Secretary of State issues relating to prudent investment practice.

4. In addition the Chartered Institute of Public Finance & Accountancy (CIPFA) has published a revised Code of Practice for Treasury Management in the Public Services in December 2017. This replaces the 2011 Code which had been adopted in full by Middlesbrough Council. The revised Code requires the Council to clearly state, in the Annual Investment Strategy document, its policy on effective control, and monitoring of its treasury management function. These controls are set out in Treasury Management Practices (TMP's) which have been approved as part of acceptance of the previous Code.

5. The revised Strategy, showing where the Guidance has determined Council policy, can be set out as:

ANNUAL INVESTMENT STRATEGY 2020/21

6. Middlesbrough Council 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.

7. 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.

8. Middlesbrough Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy in advance of the year, a mid-year review which will include an annual report on the previous year, in the form prescribed in its TMP's. Revised Strategies can be presented to the Council for approval at any other time during the year if the Director of Finance considers that significant changes to the risk assessment of significant parts of the authority's investments has occurred.

9. Middlesbrough Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Director of Finance. The execution and administration of treasury management decisions is further delegated to *the Head of Finance & Investments*, who will act in accordance with the organisation's policy statement and TMPs and CIPFA's *Standard of Professional Practice on Treasury Management.*

10. Middlesbrough Council nominates the Corporate Affairs & Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

11. The Council is very circumspect in its use of credit rating agencies with the section on Specified Investments setting out the current policy. Ratings are monitored on a real time basis as and when information is received from either our treasury management consultants or any other recognised source. Decisions regarding inclusion on the Approved List are made on the basis of market intelligence drawn from a number of sources.

12. All staff involved in treasury management will, under the supervision of *the Head of Finance & Investments*, act in accordance with the treasury management practices and procedures, as defined by the Council. Such staff will undertake relevant training, identified during the Council's induction process and, on an on-going basis, the Council's appraisal policy.

13. The general policy objective contained in the guidance is that local authorities should invest prudently the short-term cash surpluses held on behalf of their communities. The guidance emphasises that priority should be given to security and liquidity rather than yield. Within that framework the authority must determine a category of borrowers, who must be of "high credit quality" classified as **Specified Investments**, with whom it can invest surplus cash with minimal procedural formalities and further identify a category of borrowers classified as **Non-Specified Investments**, with whom it can also invest but subject to prescribed limits.

14. Although the guidance definition of Non-Specified Investments is "one not meeting the definition of a Specified Investment", the authority is required to identify which categories of investments are identified as prudent to use and the limits on any such investment either individually or in total. It is because some organisations do not subscribe to credit rating agencies that they have to be included as Non-Specified Investments, rather than any concern over their creditworthiness.

15. The guidance defines investment in such a way as to exclude pension fund and trust fund investments. In practice, Middlesbrough Council, in its role as Administering Authority for the Teesside Pension Fund, follows similar procedures as approved by Members as part of compliance with the CIPFA Code of Practice, albeit with different limits.

LIMITS & DEFINITION OF SPECIFIED INVESTMENTS

16. The following are currently determined as meeting the criteria for Specified Investments:

17. The investment is made with the UK Government, or a local authority (as defined in the Local Government Act 2003), or a police authority, or fire, or a UK Nationalised Industry, or UK Bank, or UK Building Society.

18. The investment is made with a Money Market Fund that, at the time the investment is made, has a rating of AAA.

19. The investment is made with one of the bodies listed in section 4 of Schedule 1E of the current version of the Treasury Management Practices document which, at the time the investment is made, has a short-term "investment grade" rating with either Standard & Poors, Moody's Investors Search Ltd or Fitch Ratings Ltd (or in the case of a subsidiary the parent has such a rating). Where ratings awarded differ between the rating agencies any one award below investment grade will prevent the investment being categorised as a Specified Investment. The rating of all listed bodies must be monitored on a monthly basis. Where officers become aware of a downward revision of rating, that moves the body out of the "investment grade" category, between such monthly checks, the body should be removed from the list of Specified Investments and, if considered appropriate, the investment should be recalled.

20. All specified investments must be denominated in sterling and must be one where the authority may require it to be repaid or redeemed within 12 months of the date on which the investment is made and must be considered of high credit quality. This is defined as having met the criteria set out above. The investment must not constitute the acquisition of share capital or loan capital in any body corporate.

- The minimum % of the total of all investments which must be Specified Investments, at the time the investment is made, is 70%
- The maximum investment with any one counterparty is £15 million, except for the Debt Management Office which is has no limit.
- The maximum investment in any one group (i.e. a bank and its wholly-owned subsidiaries) is £15m.

LIMITS & DEFINITION OF NON-SPECIFIED INVESTMENTS

21. These categories of investment currently meet the criteria for non-specified investments:

22. The investment is made with a UK bank, or UK building society, or a UK subsidiary of an overseas bank.

23. The investment is made with one of the bodies listed in section 4 of Schedule 1E of the current version of the Treasury Management Practices document, which is not a Specified Investment.

24. The investment is for a period of one year or longer.

25. All non-specified investments must be denominated in sterling. The investment must not constitute the acquisition of share capital or loan capital in any body corporate.

- The maximum % of the total of all investments which can be non-specified investments, at the time the investment is made, is 30%.
- The maximum investment with any one counterparty is £15 million
- The maximum investment in any one group (i.e. a bank and its wholly-owned subsidiaries) is £15m.
- The maximum % of the total of all investments that have an outstanding period of one year or longer, at the time the investment is made, is 10%.

26. The maximum period for which an investment can be made is 3 years, with the maturity date no more than 3 years and 1 month from the time the deal is agreed.

27. As referred to earlier in the report, borrowing should be kept at, or below, the expected capital financing requirement over the medium term to reduce the risk of exposure to interest rate fluctuations. The balance of ‘net borrowing’ (loans less investments) should also be monitored to, where prudent, minimise interest rate differences.

28. The Council considers that it is empowered by Section 12 of the Local Government Act 2003 for the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future. While not “borrowing to invest” it is prudent to invest monies raised in advance of expenditure. As required by the Guidance such investment is permitted providing the anticipated expenditure is within this or the next financial year or within a period of eighteen months, whichever is the greater.

TREASURY MANAGEMENT POLICY STATEMENT

29. Middlesbrough Council 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.'

30. The Council 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 those risks.

31. The Council 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.

32. The high level policies and monitoring arrangements adopted by the Council for Borrowing and Investments are as follows:

<u>Borrowing</u>

- Any borrowing decisions will aim to strike an appropriate risk balance between securing low interest rates and achieving cost certainty over the periods for which funds are required. Economic forecasts available from our treasury management advisers and any other available sources will be used to form a view on the target borrowing rates and overall borrowing strategy;
- Any decisions should also look to maintain the stability and flexibility of the longer term debt portfolio, given the current low interest rate environment where short term borrowing or borrowing from internal resources offer revenue budget savings;
- The main sources of funding for external borrowing for the Council are the Public Works Loan Board, Other Local Authorities and private sector financial institutions;

<u>Investments</u>

- The CIPFA and MHCLG guidance require the Council to invest its funds prudently and to have regard to security, liquidity and yield when making these decisions;
- Security being the arrangements in place to protect principal sums invested by a local authority;
- Liquidity being to ensure that enough cash resources are available on a day to day basis for transactional needs;
- Yield being the interest rate and total financial return applicable to the investment being made;

- With these strategic issues in mind, the management of credit risk (or security) is key to the Council's investment strategy and any subsequent activity. The Council uses the external advisers' credit worthiness matrix to determine limits with individual counterparties.

INTRODUCTION

33. Local authorities are required each year to set aside some of their revenue income as provision for debt repayment. There is a simple duty for an authority each year to make an amount of revenue provision, which it considers “prudent”. (Minimum Revenue Provision) MRP Guidance makes recommendations to authorities on the interpretation of that term.

34. Authorities are legally obliged to “have regard” to any such guidance – which is exactly the same duty as applies to other statutory guidance including, for example, the CIPFA Prudential Code, the CIPFA Treasury Management Code and the CLG Guidance on Investments.

35. Authorities are asked to prepare an annual statement of their policy on making MRP and to have this approved by the body before the start of each financial year.

MEANING OF “PRUDENT PROVISION”

36. The main part to the guidance is concerned with the interpretation of the term “prudent provision”. The guidance proposes a number of options. It explains that provision for repayment of the borrowing, 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 or has economic benefit. It should also cover the gap between the Capital Financing Requirement and the various sources of capital income available to the Council to finance its capital programme, such as capital receipts, capital grants, contributions and direct revenue financing.

OPTIONS FOR PRUDENT PROVISION

Option 1: Regulatory Method

37. For debt supported by (Revenue Support Grant) RSG in previous years, authorities will be able to continue to use the formulae in regulations, since the RSG was provided on that basis.

Option 2: CFR Method

38. This is a technically simpler alternative to Option 1 and may also be used in relation to supported debt. While still based on the concept of the Capital Financing Requirement (CFR), which can be derived from the balance sheet, it avoids the complexities of the formulae in the regulations.

Option 3: Asset Life Method

39. For new borrowing under the Prudential system (from 2008) for which no government support is given, there are two main options. Option 3 is to make provision for debt repayment in **equal annual instalments** 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.

40. The formula allows an authority to make **voluntary extra provision** in any financial year that this is affordable.

41. In the case of the construction of a new building or infrastructure, MRP would not need to be charged until the new asset comes into service. This "**MRP holiday**" would be perhaps 2 or 3 years in the case of major projects 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

42. Alternatively, for new borrowing under the prudential framework 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.

43. Councils will normally need to follow the standard procedures for calculating depreciation when making this revenue provision.

Option 5: 2% Annuity Method

44. This method recognises the time value of money and the useful life of the assets funded from borrowing and is seen as a fairer way of charging MRP. It is supported by the Council's treasury management advisers (Arlingclose) and is being adopted by many local authorities nationally as the way of accounting from pre 2008 debt.

2021/2022 MINIMUM REVENUE PROVISION -

STATEMENT FOR MIDDLESBROUGH COUNCIL

45. The Secretary of State recommends that before the start of each financial year a local authority prepares a statement of its policy on making MRP in respect of that financial year and submits it to the full council as part of its budget setting process. The statement should indicate which of the options listed above are to be followed in the financial year.

46. For supported capital expenditure Middlesbrough Council intends to use option 5, a 2% annuity basis for the coming financial year.

47. For unsupported capital expenditure Middlesbrough Council intends to use option 3, the asset life method for the coming financial year.