MID SUSSEX
DISTRICT COUNCIL

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22 February 2021

New regulations came into effect on 4 April 2020 to allow Councils to hold meetings remotely via electronic means. As such, Council and Committee meetings will occur with appropriate Councillors participating via a remote video link, and public access via a live stream video through the Mid Sussex District Council's YouTube channel.

Dear Councillor,

A meeting of **AUDIT COMMITTEE** will be held **VIA REMOTE VIDEO LINK** on **TUESDAY, 2ND MARCH, 2021 at 5.00 pm** when your attendance is requested.

Yours sincerely,

KATHRYN HALL

Chief Executive

A G E N D A

		Pages
1.	Roll Call and Virtual Meeting Explanation.	
2.	To receive apologies for absence.	
3.	To receive Declarations of Interest from Members in respect of any matter on the Agenda.	
4.	To confirm the Minutes of the previous meeting held on 17 November 2020.	**3 - 8**
5.	To consider any items that the Chairman agrees to take as urgent business.	
6.	Internal Audit - Monitoring Report 15th February 2021.	**9 - 12**
7.	Three Year Internal Audit Plan.	**13 - 18**
8.	Annual Audit Letter.	**19 - 48**
9.	Treasury Management Strategy Statement and Annual Investment Strategy 2021/22 to 2023/24.	**49 - 84**

10. Capital Strategy 2021/22. **85 - 92**

11. Questions pursuant to Council Procedure Rule 10.2 due notice of which has been given.

To: **Members of Audit Committee:** Councillors M Pulfer (Chair), R Cromie (Vice-Chair), A Boutrup, M Cornish, S Hicks and L Stockwell

Minutes of a meeting of Audit Committee held on Tuesday, 17th November, 2020 from 5.00 pm - 5.38 pm

Present: M Pulfer (Chair)
R Cromie (Vice-Chair)

A Boutrup S Hicks L Stockwell

Absent: Councillor M Cornish

1. ROLL CALL AND VIRTUAL MEETING EXPLANATION.

The Chairman introduced the meeting and took a roll call of Members in attendance.

The Legal Officer explained the virtual meeting procedure.

2. TO RECEIVE APOLOGIES FOR ABSENCE.

Apologies were received from Cllr Cornish.

3. TO RECEIVE DECLARATIONS OF INTEREST FROM MEMBERS IN RESPECT OF ANY MATTER ON THE AGENDA.

None.

4. TO CONFIRM THE MINUTES OF THE MEETING HELD ON 15 SEPTEMBER 2020.

The Minutes of the meeting of the Committee held on 15 September 2020 were agreed as a correct record and signed by the Chairman.

5. TO CONSIDER ANY ITEMS THAT THE CHAIRMAN AGREES TO TAKE AS URGENT BUSINESS.

The Chairman had no urgent business.

6. AUDIT RESULTS REPORT 2019/20.

Kevin Suter, Ernest & Young Associate Partner, introduced the report and thanked the Council's Finance Team for their assistance with this year's audit especially given the current Covid-19 environment which made auditing more difficult.

Jack Dunkley, Ernest & Young External Auditor, highlighted three main areas of note. He referred to P.14 which noted that the audit for the year ended 31 March 2020 was complete and that the two outstanding items usually are completed after the Audit Results Report is presented to the Committee. He then referred to P.21 which highlighted the work of EY Real Estates review of the Council's investment properties which identified a net difference of £6.9m on the property valuations. He finally referred to P.25, confirmed that EY had looked at management's forecast of next 12

month period and underlying assumptions that goes with it as well as the disclosures management made in the accounts to check there were in line with the standard; EY found the assessment to be reasonable, assumption to be well supported and the disclosures were in line with the standard.

The Chairman thanked EY for the supportive words on the Council's collaboration with them.

A Member sought clarification on the how the difference in property valuation was arrived at and enquired what learning can be taken from it to ensure future valuations would match the yield.

The Ernest & Young External Auditor confirmed that the focus is on the key assumptions regarding yield and future income which is sense-checked and compared against published benchmarks such as Knight Frank.

The Member then asked whether there is an internal system to utilise the information going forward.

Peter Stuart, Head of Corporate Resources, confirmed that the difference of valuations is a result of differences in opinions. The initial valuations from Wilks Head & Eve was put into the Statement of Accounts in good faith and that EY sense-checked the valuations and submitted a different value to theirs. He added that the property valuation is only a 'book value' and that it would likely change next year.

A Member referred to the uncorrected misstatement of £112k identified in the pension assets and questioned whether it is a profit or a loss and whether the Council is content that this is a misstatement with no further adjustments to be made.

The Head of Corporate Resources replied that the asset value has been understated by £112k compared to the total liabilities of £15m however it is only a matter of opinion of the Council's portion of the County Council pension fund. He added that the figure was not changed as it's a non-material change to the overall accounts and that the change would require a large amount of reprinting and recalculating in the Statement of Accounts.

The Chairman noted that no Member wished to speak so moved to the recommendation to receive the report which was approved unanimously.

RESOLVED

The Audit Committee received the report.

7. FINANCIAL STATEMENTS 2019/20.

Peter Stuart, Head of Corporate Resources, introduced the report which presented the Financial Statements to the Committee for approval. He noted the Finance Team's move to a new fully cloud-based Tech1 Financial System which has made work during the pandemic much easier. He thanked the Finance Team for their hard work in the last 6 months.

A Member referred to the heading Employee Benefits Accrual listed on P.66 and sought clarification as to whether £146,000 is a normal figure and if the Council has accrued the cost of the staffing at the Leisure Centres.

The Head of Corporate Resources confirmed that the figure is always around £110,000 so whilst £146,000 is higher than usual it is however not alarming. He highlighted that the figure may be higher next year as officers have been working at home more and had fewer opportunities to take leave during lockdowns. He added that the cost of the staffing at the Leisure Centres fell within the financial year 2020/21 therefore it would not be included in the Statement of Accounts before the Committee.

The Member referred to P.77 and noted that the 'Impairment' expenditure value had decreased however asked whether the Council was expecting that to increase due to the Covid-19 Pandemic. She also referred to P. 87 and the revaluations heading and sought an understanding as to how the fair value was arrived at.

The Head of Corporate Resources confirmed that written answers would have to be provided to the Member outside of the meeting.

The Member referred to the Contingent Liabilities on P.114 and enquired whether the NHS Trust Business Rates feature in the accounting figures.

Cathy Craigen, Business Unit Leader for Finance, confirmed that the Contingent Liabilities aren't included in the figures of the accounts as the reference is only for Members to note.

The Member asked if there was any indication on what the figure of NHS Trust Business Rates is as she noted a reference in the report that it may not come to anything, but the Council would have to work on the basis that it does.

The Business Unit Leader for Finance confirmed that figure has not been quantified as it hasn't reached the stage of doing and therefore is only noted in the Accounts however the figure will be included when it can be quantified.

A Member noted the post balance sheet for the Leisure Centres which were signed off in August and assumed that the figures for reopening the Centres are not included in the Accounts.

The Head of Corporate Resources confirmed that the costs of reopening the would be included in the Statement of Accounts 2020/21.

The Chairman noted that no Member wished to speak so moved to the recommendation to approve the Financial Statements which was approved unanimously.

RESOLVED

The Audit Committee approved the Financial Statements.

8. INTERNAL AUDIT - MONITORING REPORT 6TH NOVEMBER 2020.

Chris Bower, Senior Internal Auditor, introduced the report which sought to update the Committee on the progress of the 2020/2021 Internal Audit Plan and to report on the progress made in implementing previously agreed recommendations.

A Member sought further detail on the purchase orders that were not recorded on the Contract Register and the proposed solution to ensure that it doesn't occur again.

Tom Clark, Head of Regulatory Services, confirmed that the requisite forms were completed however they were not able to be recorded on the Contract Register. He added that there will be greater checks on the contracts and that a computer upgrade would allow the legal officer concerns to add the purchase order onto the Contract Register themselves.

A Member enquired whether the payments of the purchase orders not recorded on the Contract Register were single payments or reoccurring payments.

The Senior Internal Auditor explained that they are single unit payments.

The Member then enquired whether we know why the payments were made to the organisations as it could be open to fraudulent activities.

The Head of Regulatory Services confirmed that the £1.375m to Southern Water Services Ltd relates to money passed from Central Government to stop bad smells coming from their plant to encourage housebuilding and the Balfour Beatty Construction Limited for cabling.

The Chairman noted that no Member wished to speak so moved to the recommendation to receive the report which was approved unanimously.

RESOLVED

The Committee received and noted the report.

9. COMMITTEE WORK PROGRAMME 2020/21

Tom Clark, Head of Regulatory Services, introduced the Committee's Work Programme which noted business for the next meeting of the Committee on 2 March 2021.

A Member noted two outstanding items that he would like to be brought to the next Committee to ensure that sight is not lost on them; update on the counter-party comparisons and the use of ethical investment.

Peter Stuart, Head of Corporate Resources, believed that the Contract Register had already been discussed the counter-party comparisons and the ethical investments would be provided in the Annual Investment Strategy 2021/22 to 2023/24 due to be before the Committee on 2 March 2021 and then would be put before a meeting of the Council.

The Chairman noted that no Member wished to speak so moved to the recommendation to note the Work Programme which was approved unanimously.

RESOLVED

The Committee noted the Committee's Work Programme.

10. QUESTIONS PURSUANT TO COUNCIL PROCEDURE RULE 10.2 DUE NOTICE OF WHICH HAS BEEN GIVEN.

None.

The meeting finished at 5.38 pm

Chairman

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INTERNAL AUDIT – MONITORING REPORT 15th February 2021

REPORT OF: Audit and Risk Manager
Contact Officer: Gillian Edwards
Email: gillian.edwards@midsussex.gov.uk Tel: 01444 477241
Wards Affected: All MSDC Wards
Key Decision: No
Report to: Audit Committee
2nd March 2021

Purpose of Report

1. The purpose of this report is twofold; to update the Committee on the progress of the 2020/2021 Internal Audit Plan and to report on the progress made in implementing previously agreed recommendations.

Recommendation

2. The Committee is asked to receive this report.

Background

3. Work Completed

Since the last report, as at 31st August 2020, the following reviews have been completed.

Audit Title	Audit Opinion
Council Tax	Satisfactory
NNDR	Substantial
Housing Benefits	Substantial

4. Work in Progress

The reviews in progress and other work that we have undertaken in the period are shown at Appendix A. All work has been planned and allocated to Audit staff and we are confident that the audit plan will be complete by 31st March 2021

5. High priority findings in this period

There were no high priority findings identified in this period.

6. Follow Up Audits

Contract Register Audit 2020/2021
Final Report Date: 6th November 2020

During this review, it was established that the Contract Register was not being updated in accordance with the Local Government Transparency Code 2015, which requires Local Authorities to publish, on a quarterly basis, details of each individual item of expenditure that exceeds £500 and we can confirm that this is being done.

We reported at the last meeting that the Contract Register had not been kept up to date, with the following purchases having not been included:

Company	Value April-September 2020	Status as at 15th February 2021
Southern Water Services Ltd **	£1,375,757	Not on Contract Register
Zurich Municipal Insurance **	£111,857	
Arthur J. Gallagher Insurance Brokers Limited **	£73,257	Not on Contract Register
Cross Stone Urban Regeneration	£34,672	Not on Contract Register
Ernst & Young LLP	£37,479	Not on Contract Register
Balfour Beatty Construction Limited	£26,167	
Pagoda Security and Facilities Management Ltd	£22,161	Not on Contract Register
Crawley Borough Council (Main)	£15,776	Not on Contract Register
Symatrix Limited	£15,317	
JLT Specialty Limited- Insurance	£14,554	
Total	£1,726,997	

We have reviewed the Contract Register on 15th February 2021 and can confirm that whilst some transactions have now been included, others are still outstanding. We did not undertake any further testing at this time.

It was confirmed with the Solicitor and Head of Regulatory Services that this should have been done as the Register is being updated on a monthly basis. It is advised that the Contract Register is reviewed before the next meeting of this Committee.

Background Papers

- Internal Audit reports relating to 2020/2021
- Working papers relating to 2020/2021

Appendix A

Internal Audit Plan 2020/2021

Progress Report as at 15th February 2021

Audit	Audit Plan Year	Audit Opinion-Assurance	Number of High Priority Findings	Comments
A. Work Completed in the Current Period				
Council Tax	2020/21	Satisfactory		
Housing Benefits	2020/21	Substantial		
NNDR	2020/21	Substantial		
B. Work In Progress				
National Fraud Initiative Data Matching	2020/21			All data matches uploaded to NFI
Grants Assurance Work	2020/21			
Payroll	2020/21			
Treasury Management	2020/21			
C. Follow Up Audits				
Contract Register	2020/21			Recommendation not implemented
D. To Complete Before 31.3.21				
Payments (Creditors)	2020/21			Resources allocated
Income Collection (Sundry Debtors)	2020/21			Resources allocated
Cash and Bank	2020/21			Resources allocated
Budgetary Control	2020/21			Resources allocated
Financial Management System (FMS)	2020/21			Resources allocated
Capital Accounting	2020/21			Resources allocated

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THREE YEAR INTERNAL AUDIT PLAN

Report from:	Audit and Risk Manager
Contact Officer:	Gillian Edwards
	Email@ gillian.edwards@midsussex.gov.uk
	Tel:~(01444) 477241
Wards Affected:	All
Key Decision:	No
	Date of Meeting – 2nd March 2021

1. **PURPOSE OF REPORT**

To inform the Committee of the detailed work proposed for 2021/2022 and the overall Internal Audit Plan, for the three years 2021/2022, 2022/2023, and 2023/2024.

2. **SUMMARY**

2.1 The three-year internal audit plan has been compiled to respond to the changes within the organisation, its structure and how its services are delivered, whilst also ensuring that key controls are effective.

2.2 The plan allows for examination of the main financial areas from a systems and ICT perspective, which is key to ensuring the Council's finances remain properly controlled, whilst also undertaking strategic and service-based work each with a varying risk to the organisation.

2.3 The plan also includes some specific reviews from previous audit work, designed to ensure that agreed actions have been satisfactorily implemented and that the Council is being consistent in its approach year on year.

2.4 The plan continues to include coverage of specific key controls agreed with the External Auditor to support their year-end work as required.

2.5 It should be noted that the coverage in year 3 may be subject to amendment, based upon changing situations, risks identified, and priorities.

3. **RECOMMENDATIONS**

The Committee is asked to comment on the detailed Internal Audit Plan for 2021/2022 (Appendix A) and the 3 Year Internal Audit Plan (Appendix B).

4. **INTRODUCTION AND BACKGROUND**

4.1 The work of Internal Audit is managed through a risk-based planning process which this year comprises detailed one year and three year plans.

4.2 The purpose of this report is for the Committee to consider the proposed Internal Audit Plans.

5. INTERNAL AUDIT PLANS

Preparation

5.1 The preparation process for the detailed one year and three year plans included engagement with management, consideration of findings of previous audit work and the inclusion of fundamental systems, including the major financial systems.

5.2 The detailed plan for 2021/2022 is shown in Appendix A, with the three year plan in Appendix B.

Fundamental Systems

5.3 These are the main financial systems and as such, adequate control is key to the proper operation of the Council's financial affairs. The External Auditor no longer relies upon the work of Internal Audit in formulating their audit opinion, and tests the systems themselves to gain assurance. These systems are still examined annually by Internal Audit and a total of 100 days is allocated for this work in 2021/2022, which represents 45% of the total available audit days.

Computer Audit

5.4 This category deals with examining the control of the Council's main computer systems and infrastructure. An ICT risk assessment is undertaken at the beginning of each financial year, to determine how the resources allocated to this area can be best utilised.

Risk Based and Corporate Audits

5.5 This area relates to work requested and/or having been identified by Internal or External audit as a key risk to the Council.

Follow Ups

5.6 It is important for the effectiveness of Internal Audit that there should be a process of following up previously agreed actions to ensure they are implemented satisfactorily and in a timely manner. A total of 10 days has been allocated for this work each year.

Contingency

5.7 After consultation with the Head of Corporate Resources, a total of 220 days has been agreed to allow coverage of areas identified as being necessary to include comprehensive coverage of areas where it is deemed the risk is sufficient to require this. A total of 12 days has been allocated to Contingency at present, and there is scope to increase this if it is deemed necessary by the Head of Corporate Resources.

Management and Planning

5.8 In addition to undertaking the audits referred to above, Internal Audit also carry out a number of support and planning activities. These include liaison with the External Auditor to ensure the two functions complement each other and avoid duplication. In addition, Internal Audit liaises with management to agree the audit programmes and scope, allocate appropriately skilled resources, provide guidance to management on internal issues and present to the Audit Committee.

Resources

5.9 The Internal Audit Service for the forthcoming financial year has a total of 220 days allocated to it, with the same in years two and three. This will be kept under constant review and any changes will be discussed and agree with the Head of Corporate Resources.

6. Risk Assessment

6.1 This plan has been produced after engaging with stakeholders, consideration of the findings of Internal and External Audit and review of relevant documentation. There is scope for additional resources to be allocated to the plan, to cover unexpected eventualities and unforeseen risks, by agreement with the Head of Corporate Resources and the new Internal Audit service provider.

6.2 The three year plan is intended to focus on the strategic direction of the Council. Management Team are committed to Heads of Service taking responsibility for ensuring that controls are maintained within their areas of responsibility. If there are concerns over any issues, these can be discussed with Internal Audit for advice and there is sufficient flexibility in the plan to allow for this. Additionally, Heads of Service can ask Internal Audit to undertake examinations on a one off basis, subject to agreement by the Head of Corporate Resources.

7. Policy Context

This report explains how the Internal Audit function will contribute to the work of the Council Internal Audit is a statutory function required under the Accounts and Audit Regulations 2015.

8. Financial Implications

8.1 The detailed 2021/2022 Internal Audit Plan has been compiled to ensure it remains within the budget agreed with the Head of Corporate Resources.

Appendix A

Mid Sussex District Council Internal Audit Plan 2021/2022

	Systems	IT	Total	Comments
Fundamentals				
Housing Benefits	20		20	
Council Tax	12		12	
NNDR	12		12	
Payroll	10		10	
Income Collection (Cashiers)	8		8	
Treasury Management	5		5	
Payments (Creditors)	8		8	
Sundry Debtors	8		8	
Capital Accounting & Asset Management	5		5	
Budgetary Control	5		5	
FMS	6		6	
Sub Total	**99**	**0**	**99**	
Risk Based and Corporate				
Grant Assurance Work	8		8	
Risk Management Awareness and Training	8		8	
Sub Total	**115**	**0**	**115**	
Anti-Fraud Work				
National Fraud Initiative Data Matching	30		30	
Sub Total	**145**		**145**	
ICT Audits				
Prioritisation of ICT Resources		10	10	
Cyber Security		10	10	
Sub Total	**145**	**20**	**165**	

	Systems	IT	Total	Comments
Follow Ups	10		10	
Contingency	15		15	
Sub Total	**170**	**20**	**190**	
Management and Planning				
Committees	10		10	
Operational Management	10		10	
Head of Audit Time	10		10	To include preparation of Head of Audit Annual Report
Total Days	**200**	**20**	**220**	

Appendix B

Mid Sussex District Council – 3 Year Internal Audit Plan

	2020/2021 Year 1	2021/2022 Year 2	2022/2023 Year 3
Fundamentals			
Housing Benefits	20	20	20
Council Tax	12	12	12
NNDR	12	12	12
Payroll	10	10	10
Income Collection (Cashiers)	8	8	8
Treasury Management	5	5	5
Payments (Creditors)	8	8	8
Sundry Debtors	8	8	8
Capital Accounting & Asset Management	5	5	5
Budgetary Control	5	5	5
FMS	6	6	6
Risk Based and Corporate			
Grant Assurance Work	8		
Risk Management Awareness and Training	8		
Anti-Fraud Work			
National Fraud Initiative Data Matching	30	30	30
ICT Audits		20	20
Prioritisation of ICT Resources	10		
Cyber Security	10		
Follow Ups	10	10	10
Contingency	15	31	31
Management and Planning			
Committees	10	10	10
Operational Management	10	10	10
Head of Audit Time	10	10	10
Total Days	**220**	**220**	**220**

ANNUAL AUDIT LETTER

REPORT OF: Head of Corporate Resources
Contact Officer: Peter Stuart, Head of Corporate Resources
Email: Peter.Stuart@midsussex.gov.uk Tel: 01444 477315
Wards Affected: All
Key Decision No

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1. Purpose of Report

To inform the Committee of the External Auditor's Annual Audit Letter.

2. Recommendations

The Audit Committee is recommended to note the 2019/20 Annual Audit Letter

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3. **Background**

3.1 Attached at Annex 1 is the Annual Audit Letter for 2019/20. This is a document that the auditor must issue that formally records the outcome of the audit of the Statements for that year.

3.2 Members will note that it contains no new information but that it acts to summarise all the findings for the year.

3.3 The Audit Director will be able to elucidate on any points raised.

4. Financial implications

4.1 There are no financial implications arising from this report. .

5. Equalities implications

5.1 The report raises no implications of this nature.

6. Risk analysis

6.1 No material risks arise from this report

Background Papers
None

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Mid-Sussex District Council

Annual Audit Letter for the year ended 31 March 2020

December 2020

ANNEXE 1

EY

Building a better working world

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Public Sector Audit Appointments Ltd (PSAA) have issued a 'Statement of responsibilities of auditors and audited bodies'. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk). [**OR** As part the Auditor Engagement process, we have agreed with you the respective responsibilities of auditors and audited bodies. Copies of the Engagement Letter and Terms and Conditions of our appointment are available from the Chief Executive or via the bodies minutes on their website].

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

The 'Terms of Appointment (updated April 2018)' issued by PSAA [**OR** The Terms and Conditions of our appointment contained within the Engagement Letter] sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

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

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

Section 1

Executive Summary

Executive Summary

We are required to issue an annual audit letter to Mid-Sussex District Council (the Council) following completion of our audit procedures for the year ended 31 March 2020. Covid-19 had an impact on a number of aspects of our 2019/20 audit. We set out these key impacts below.

Area of impact	Commentary
Impact on the delivery of the audit	
▸ Changes to reporting timescales	As a result of Covid-19, new regulations, the Accounts and Audit (Coronavirus) (Amendment) Regulations 2020 No. 404, have been published and came into force on 30 April 2020. This announced a change to publication date for final, audited accounts from 31 July to 30 November 2020 for all relevant authorities. We worked with the Council/ Pension Fund to deliver our audit in line with the revised reporting timescale.
Impact on our risk assessment	
▸ Valuation of Property Plant and Equipment	The Royal Institute of Chartered Surveyors (RICS), the body setting the standards for property valuations, issued guidance to valuers highlighting that the uncertain impact of Covid-19 on markets might cause a valuer to conclude that there is a material uncertainty. Caveats around this material uncertainty have been included in the year-end valuation reports produced by the Council's external valuer. We consider that the material uncertainties disclosed by the valuer gave rise to an additional risk relating to disclosures on the valuation of property, plant and equipment.
▸ Disclosures on Going Concern	Financial plans for 2020/21 and medium term financial plans will need revision for Covid-19. We considered the unpredictability of the current environment gave rise to a risk that the council would not appropriately disclose the key factors relating to going concern, underpinned by managements assessment with particular reference to Covid-19 and the Council's actual year end financial position and performance.
▸ Events after the balance sheet date	We identified an increased risk that further events after the balance sheet date concerning the current Covid-19 pandemic will need to be disclosed. The amount of detail required in the disclosure needed to reflect the specific circumstances of the Council.
Impact on the scope of our audit	
▸ Information Produced by the Entity (IPE)	We identified an increased risk around the completeness, accuracy, and appropriateness of information produced by the entity due to the inability of the audit team to verify original documents or re-run reports on-site from the Council's systems. We undertook the following to address this risk: ▸ Used the screen sharing function of Microsoft Teams to evidence re-running of reports used to generate the IPE we audited; and ▸ Agree IPE to scanned documents or other system screenshots.
▸ Consultation requirements	Additional EY consultation requirements concerning the impact on auditor reports. The changes to audit risks and audit approach changed the level of work we needed to perform.

Executive Summary (cont'd)

The tables below set out the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's:	
► Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council as at 31 March 2020 and of its expenditure and income for the year then ended.
► Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts.
► Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you [have/have not] put in place proper arrangements to secure value for money in your use of resources.

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

Executive Summary (cont'd)

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	We had no matters to report.

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 17 November 2020
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 20 November 2020

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

Kevin Suter
Associate Partner
For and on behalf of Ernst & Young LLP

Section 2

Purpose and Responsibilities

Purpose

The Purpose of this Letter

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

We have already reported the detailed findings from our audit work in our 2019/20 Audit Results Report to the 17 November 2020 Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

Responsibilities

Responsibilities of the Appointed Auditor

Our 2019/20 audit work has been undertaken in accordance with the Audit Plan that we issued on 3 March 2020 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- Expressing an opinion:
  - On the 2019/20 financial statements; and
  - On the consistency of other information published with the financial statements.
- Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- Reporting by exception:
  - If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - Any significant matters that are in the public interest;
  - Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

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

Responsibilities of the Council

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

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

Section 3

Financial Statement Audit

Financial Statement Audit

Key Issues

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

We audited the Council's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office and issued an unqualified audit report on 17 November 2020.

Our detailed findings were reported to the November 2020 Audit Committee.

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

Significant Risk	Conclusion
Misstatements due to fraud or error The financial statements as a whole are not free of material misstatements whether caused by fraud or error. As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.	Our audit work found no evidence that management had attempted to override internal controls. We have not identified any instances of inappropriate judgements being applied. We did not identify any other transactions during our audit which appeared unusual or outside the Authority's normal course of business. This conclusion is based on detailed testing of accounts entries susceptible to potential manipulation

Financial Statement Audit (cont'd)

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

Significant Risk	Conclusion
Risk of fraud in revenue and expenditure recognition Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition. From our risk assessment, we have assessed that the risk manifests itself solely through the inappropriate capitalisation of revenue expenditure to improve the financial position of the general fund. Capitalised revenue expenditure can be funded through borrowing with only minimal MRP charges recorded in the general fund, deferring the expenditure for 30+ years when the borrowing is repaid **To gain assurance in this area we:** Examined invoices for significant additions, capital expenditure authorisations, leases and other data that support the additions. We reviewed the sample selected against the definition of capital expenditure in IAS 16. We extended our testing of items capitalised in the year by lowering our testing threshold. We will also review a larger random sample of capital additions below our testing threshold. Journal testing – we used our testing of Journals to identify high risk transactions, such as items originally recorded as revenue expenditure and subsequently capitalised.	We are satisfied that capital additions made in the year met the requirements of IAS 16, and had been correctly capitalised

Financial Statement Audit (cont'd)

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

Significant Risk	Conclusion
Valuation of Investment Property The Council holds a significant investment property portfolio. The valuation of property is complex and subject to several assumptions and judgements. A small movement in these assumptions can have a material impact on the financial statements. Difficulties in the retails sector in particular have led to many retailers, including well-known names, closing stores, going into administration, or otherwise looking to reduce their rental costs by renegotiating existing leases. These difficulties have had a direct impact on the value of the retail units (high street shops, out of town retail parks and shopping centres) leased to retailers. **To gain assurance in this area we:** Considered the work performed by the Council's valuer, this included a review of the adequacy of the scope of the work performed, their professional capabilities and the results of their work; Sample tested key asset information used by the valuer in performing their valuation (e.g. floor plans to support valuations based on price per square metre); Instructed our own Property valuation team (EY Real Estates) to review a sample of property valuations performed by the Councils Valuer Consider the annual cycle of valuations to ensure that investment properties are being revalued every year. Tested accounting entries have been correctly processed in the financial statements; and We also noted that the Council valuer attached a 'material uncertainty' clause to their valuation as a result of Covid-19. We reviewed the adequacy of the disclosure of this in the Council's accounts.	We instructed our property valuation team to review a sample of the valuation performed by the Council. The review focuses on whether the valuation is based on reasonable and supportable assumptions. From this review we identified several asset values were materially misstated. The key areas our valuation team identified differences on were; - Where the current tenant has a short period remaining on their tenancy, the valuation should allow for a void and incentive period at the end of the current lease - Purchase costs should be deducted on the valuation due to the UK market reporting yields on a net basis - Yields assumed by the Council valuer were outside the range of published benchmarks for similar properties Following the correction of these misstatements, we conclude that the balance is fairly stated and do not modify our audit opinion in respect of this matter.

Financial Statement Audit (cont'd)

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

Significant Risk	Conclusion
New Financial Ledger System The Council introduced its new Technology One financial management system with effect from 02 September 2019. It put in place measures to migrate data on 2019/20 transactions and balances from the old to the new financial management system. The Council's 2019/20 financial statements will be prepared using data taken from the new general ledger at the end of the financial year. To ensure the production of materially accurate and complete 2019/20 financial statements, it is essential that the Council is assured over the completeness and accuracy of financial data to its new general ledger **To gain assurance in this area we:** Met with officers to discuss and understand the process for implementing the new financial management system. Reviewed the actions taken by the Council to ensure the complete and accurate migration of financial data to the new general ledger. This included reviewing the effectiveness of reconciliation processes. We also undertook our own testing on the completeness and accuracy of data migration. Met with internal audit to understand the work they had completed in 2019/20 in relation to the new ledger system. Reviewed how data from the new system maps to the statement of accounts, as part of our understanding of the accounts production process for 2019/20.	From the work performed we have sufficient assurance the data transfer from the old system to the new system was materially accurate and complete.

Financial Statement Audit (cont'd)

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

Other Risk	Conclusion
Valuation of Property Plant & Equipment The fair value of Property, Plant and Equipment (PPE) represent significant balances in the Council's accounts and is subject to valuation changes and impairment reviews. Management is required to make material judgements about key assumptions and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. **To gain assurance in this area we:** ▸ Considered the work performed by the Council's valuer, this included a review of the adequacy of the scope of the work performed, their professional capabilities and the results of their work; ▸ Sample tested key asset information used by the valuer in performing their valuation (e.g. floor plans to support valuations based on price per square metre); ▸ Consider the annual cycle of valuations to ensure that assets have been valued within a 5 year rolling programme as required by the Code for PPE. ▸ Reviewed assets not subject to valuation in 2019/20 to confirm that the remaining asset base is not materially misstated; ▸ Considered changes to useful economic lives as a result of the most recent valuation; ▸ Tested accounting entries have been correctly processed in the financial statements; and ▸ We also noted that the Council valuer attached a 'material uncertainty' clause to their valuation as a result of Covid. We reviewed the adequacy of the disclosure of this in the Council's accounts.	We are satisfied that the valuation of property, plant and equipment is fairly stated and appropriately disclosed.

Financial Statement Audit (cont'd)

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

Other Risk	Conclusion
Net pension liability valuation The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by West Sussex County Council. The Council's pension fund net liability is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2020 this totalled £15,081k. The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the County Council. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates. **To gain assurance in this area we:** ▸ Liaised with the auditors of West Sussex Pension Fund to obtain assurances over the information supplied to the actuary in relation to West Sussex County Council. ▸ Assess the work of the Pension Fund actuary (Hymans Robertson) including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by Public Sector Auditor Appointments for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team. ▸ Review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19; and ▸ Reviewed the Council's calculation of the impact of the 'McCloud' and 'Goodwin' judgement noting that the post balance sheet events did not have a material impact on the pension liability and therefore are not required to be disclosed as post balance sheet event.	We identified that the pension asset value at 31 March 2020 used by the actuary in their report was understated by £112k. As the difference is not material, we concluded that the net pension liability was fairly stated. In all other respects we have no findings to report.

Financial Statement Audit (cont'd)

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

Other Risk	Conclusion
Going Concern Disclosure Covid-19 has created a number of financial pressures throughout Local Government. There is currently not a clear statement of financial support from MHCLG that covers all financial consequences of Covid-19. There have been a number of media stories in both the national press and trade publications raising the possibilities of an increase in Chief Financial Officers using their s114 powers. This could be under s114(3), insufficient resources to fund likely expenditure. CIPFA's Code of Practice on Local Authority Accounting in the United Kingdom 2019/20 sets out that organisations that can only be discontinued under statutory prescription shall prepare their accounts on a going concern basis. However, International Auditing Standard 570 Going Concern, as applied by Practice Note 10: Audit of financial statements of public sector bodies in the United Kingdom, still requires auditors to undertake sufficient and appropriate audit procedures to consider whether there is a material uncertainty on going concern that requires reporting by management within the financial statements, and within the auditor's report. We are obliged to report on such matters within the section of our audit report 'Conclusions relating to Going Concern'. To do this, the auditor must review management's assessment of the going concern basis applying IAS1 Presentation of Financial Statements. **To gain assurance in this area we:** In light of the unprecedented nature of Covid-19, its impact on the funding of public sector entities and uncertainty over the form and extent of government support, we sought a documented and detailed consideration to support management's assertion regarding the going concern basis. Our audit procedures to review these included consideration of: ▸ Current and developing environment; ▸ Liquidity (operational and funding); ▸ Mitigating factors; ▸ Management information and forecasting; and ▸ Sensitivities and stress testing. Due to the impact of Covid-19, we also consulted internally with our risk department over the level of disclosure.	We reviewed managements Going Concern assessment and confirm their conclusion that the Council remains a Going Concern is based on reasonable and supportable assumptions. We also reviewed managements updated Going Concern Disclosure and confirmed it sufficiently detailed, transparent and accurately reflects managements underlying Going Concern assessment.

Financial Statement Audit (cont'd)

Our application of materiality

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

Item	Thresholds applied
Planning materiality	We determined planning materiality to be £1.5m (2019: £1.526m), which is 2% of Gross Revenue Expenditure reported in the accounts of £74.1 million We consider Gross Revenue Expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council
Reporting threshold	We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £74k (2019: £76k)

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

- Remuneration disclosures including any severance payments, exit packages and termination benefits:
- Related party transactions.
- We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations.

Section 4

Value for Money

Value for Money

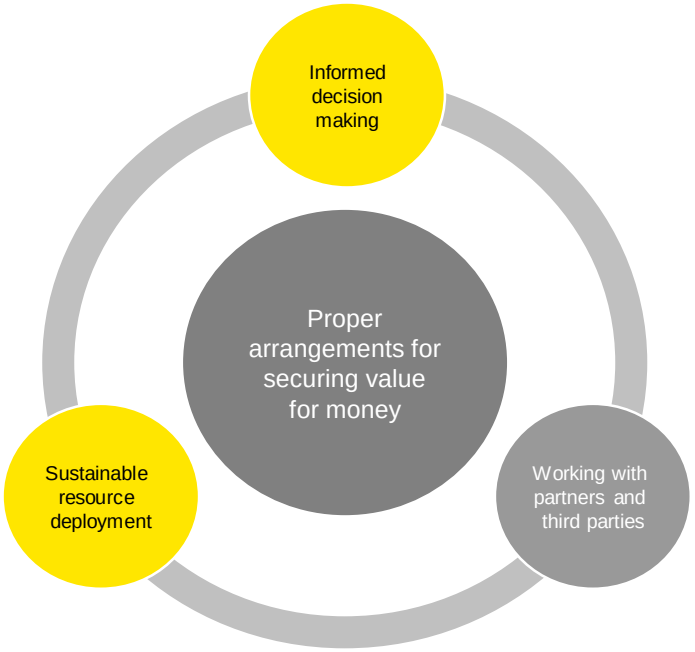
We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness in its use of resources. This is known as our value for money conclusion.

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

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

On 16 April 2020 the National Audit Office published an update to auditor guidance in relation to the 2019/20 Value for Money assessment in the light of Covid-19. This clarified that in undertaking the 2019/20 Value for Money assessment auditors should consider NHS bodies' response to Covid-19 only as far as it relates to the 2019-20 financial year; only where clear evidence comes to the auditor's attention of a significant failure in arrangements as a result of Covid-19 during the financial year, would it be appropriate to recognise a significant risk in relation to the 2019-20 VFM arrangements conclusion.

We did not identify any significant risks in relation to these criteria



Section 5

Other Reporting Issues

Other Reporting Issues

Whole of Government Accounts

We are required to perform the procedures specified by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes.

The Council is below the specified audit threshold of £500mn. Therefore, we were not required to perform any audit procedures on the consolidation pack

Annual Governance Statement

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

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

Report in the Public Interest

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

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

Written Recommendations

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

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

Other Reporting Issues (cont'd)

Objections Received

We did not receive any objections to the 2019/20 financial statements from members of the public.

Other Powers and Duties

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

Independence

We communicated our assessment of independence in our Audit Results Report to the Audit Committee on 17 November 2020. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

Our audit did not identify any controls issues to bring to the attention of the Audit Committee.

Appendix A

Audit Fees

Audit Fees

Our fee for 2019/20 is set out in the table below.

Description	Final Fee 2019/20 £	Planned Fee 2019/20 £	Scale Fee 2019/20 £	Final Fee 2018/19 £
Total Audit Fee	38,917	38,917	38,917	38,917
Scale Fee Rebasing: Changes in work required to address professional and regulatory requirements and scope associated with risk (see page 27)	25,314			N/A
Revised Proposed Scale Fee	**64,231**			38,917
Covid-19 – Increased Property valuation risk (1)	8,216			N/A
Covid 19 – Going Concern and consultation (2)	3,347			N/A
Change in FMS (3)	7,760	9,700		
Total Audit Fee	**83,554**			38,917
Other non-audit services not covered above (Housing Benefits) **(4)**	**TBC**			40,922

All audit fee variations are additional to the PSAA scale fee and will be subject to agreement with the Director of Finance and then PSAA.

Audit Fees (cont'd)

Note 1

Due to the increased risk from Covid-19, the variation includes engaging EY Real Estate, our internal property specialists, to review a sample of valuations of investment properties and EUV assets. It also incorporates the findings from that review, and adjustments needed to the valautions and the financial statements.

Note 2

Additional work required as a result of Covid-19 to review management's assessment and additional disclosures that were required in relation to going concern, and our internal consultation process undertaken to ensure that events and conditions in relation to the going concern assumption are adequately disclosed.

Note 3

The Planned Fee for 2019/20 included our initial estimate of the required work in relation to the new ledger system at £9,700. We noted the final additional fee may vary depending on the final scope of work required, and its findings and impact on the audit strategy. We completed the work in less time that originally estimated.

Note 4

Our fees for the work on the Housing Benefit Subsidy claim will be finalised after the completion of the work, aimed for 31 January 2021.

Audit Fees continued

Scale Fee Rebasing: Changes in work required to address professional and regulatory requirements and scope associated with risk

Janet Dawson, our Government & Public Sector Assurance Lead, wrote to all Chief Finance Officers and Audit Committee (or equivalent) chairs on 11 February 2020 on the subject of the sustainability of UK local public audit. Amongst other issues her letter stated that we did not believe the existing scale fees provide a clear link with both a public sector organisation's risk and complexity, and the audit profession's context for cost and fee increases, including the attractiveness of audit, investment in technology, innovation and the regulatory environment.

Around the same time, PSAA consulted on its 2020/21 audit fees (PSAA fee consulation), discussing the challenging environment, new standards and regulatory requirements. They noted an appropriate forum for fee discussions from these impacts would be between the auditor and Chief Financial Officer, to take place as soon as possible as part of planning discussions for 2019/20 audits.

The subsequent review by Sir Tony Redmond (Redmond Review) has also highlighted that audit fees in the local authority sector have dropped significantly at the same time that audit fees in other sectors have significantly risen, and that no assessment of the amount it would cost to audit each local authority based on their level of audit risk has been made in the past ten years due to the methods applied by the Audit Commission and then PSAA. As such there is no guarantee that the fee paid by each local authority accurately reflects the risk profile or amount of audit work required for their external audit.

To address these issues we undertook an analysis of the changes in professional and regulatory requirements since our last tender to PSAA was submitted, and any other known changes in audit risk. For instance, where applicable, significant commercial property investments, creation of joint ventures, subsidiaries and other similar arrangements.

We identified the proposed fee rebasing under the headings of:

- Changes in risk;
- Increased regulatory requirements; and
- Client readiness and ability to support a technologically enabled audit.

As requested by PSAA, we discussed this with management on 27 May 2020

We did not reach agreement. While management recognised many of these pressures and can see how they are reflected in the changes in the audit work, their view was that this is a decision for PSAA.

Having not reached agreement, and in light of managements comments, we will now submit the proposed rebasing to PSAA for their review and decision. We would like to thank management for their contribution to this debate and the positive manner in which they engaged with us.

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ED None

EY-000070901-01 (UK) 07/18. CSG London.

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TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2021/22 TO 2023/24

REPORT OF:	Head of Corporate Resources
Contact Officer:	Peter Stuart
	Email: peter.stuart@midsussex.gov.uk Tel: 01444 477315
Wards Affected:	All
Key Decision:	No
Report to:	Audit Committee, 2 March 2021

Purpose of Report

1. This report sets out the Council's investment and borrowing strategy for the forthcoming three years and reports the counterparty list with whom investments may be made. It also sets out the Prudential Limits that provide the parameters for approved future lending and borrowing, including the incidental cost of so doing.

Summary

2. The purchase of the Orchard Shopping Centre head lease in November 2016 necessitated borrowing of £22m from other Local Authorities. £17m has already been repaid, using the cash flow generated by matured fixed term deposits. The final £5m will be repaid in November 2021.

   Lending is restricted to the same counterparties and within the same limits as in the previous strategy approved in March 2020 except for the following proposed amendments:

   (i) Appendix D details the criteria for non-specified investments. Deposits with banks, building societies and local authorities currently are within one category with a maximum total limit of 50% of funds. Local authorities will be given a separate limit to allow flexibility to enable the service to take advantage of the best investment returns based on the liquidity needs of the Council.

   (ii) Al Rayan Bank will be added to the specified investments in Appendix C, with a maximum investment duration of 1 year. Al Rayan Bank is the UK's oldest and largest Sharia compliant retail bank and has a current credit rating of A1 from the rating agency Moodys. It operates an ethical model which excludes non-Sharia compliant investments such as in gambling, alcohol, pornography, tobacco and arms.

Recommendations

3. The Committee is recommended to propose that Council agree:

(i) the proposed Treasury Management Strategy Statement (TMSS) for 2021/22 and the following two years,
(ii) the Annual Investment Strategy (AIS) and the Minimum Revenue Provision Statement (MRP) as contained in Sections 4 and 2.3 respectively of the report;
(iii) the proposed amendments to the specified and non-specified investment appendices;
(iv) the Prudential Indicators contained within this report.

Background

4. The Council applies and upholds the Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code"). CIPFA has defined Treasury Management as:

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

5. The Code requires local authorities to produce an annual Treasury Management Strategy Statement (TMSS), which documents the Council's approach to capital financing and investments for the forthcoming financial year (2021/22) and the following two years. This report fulfils that requirement.

6. In producing the TMSS, The Local Government Act 2003 (the Act) and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years. The indicators are established to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

7. Additionally, the Act and its subsequent Investment Guidance require the Council to set out its treasury management strategy for borrowing, and to prepare an Annual Investment Strategy (AIS). The Council's borrowing position is reported in Section 3, with arrangements for making Minimum Revenue Provision (MRP) for repayment of debt explained in Section 2.3. The AIS is contained in Section 4 of this report, and describes the Council's policies for managing its investments, and for giving priority to the security and liquidity of those investments.

8. Statute requires that the AIS, MRP Statement, and Prudential Indicators are approved by full Council before the start of the new financial year.

Policy Context

9. Providing transparency and approval of the strategies contained in this report is an important part of the Council's statutory role. Treasury Management has become increasingly topical given the nature of the world's financial markets in recent years, and Members are expected to have a basic understanding of how the Council uses its reserves and cash flows which are in the stewardship of the Head of Corporate Resources.

Other Options Considered

10. None – this report is statutorily required.

Financial Implications

11. This report has no quantifiable financial implications. Interest payable and interest receivable arising from treasury management operations, and annual revenue provisions for repayment of debt, form part of the revenue budget but are not required to support the provision of services.

Risk Management Implications

12. This report has no specific implications for the risk profile of the Authority.

Equality and Customer Service Implications

13. None.

Background Papers

- Treasury Management Strategy Statement & Annual Investment Strategy 2020/21 to 2022/23 (March 2020)
- Annual Review of Treasury Management 2019-20 (September 2020)
- Review of Treasury Management Activity 1 April – 30 September 2020 (Nov. 2020)
- Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (CIPFA)
- The Prudential Code for Capital Finance in Local Authorities (CIPFA, December 2017)
- MHCLG Investment Guidance (Revised for April 2018) and MRP Guidance
- Link Asset Services report template (January 2021)

Treasury Management Strategy Statement & Annual Investment 2021/22 to 2023/24

INTRODUCTION

1.1 Background

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

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

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

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

1.2 Reporting requirements

1.2.1 Capital Strategy

The CIPFA revised 2017 Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report which will provide the following:

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

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

1.2.2 Treasury Management reporting

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

a. Prudential and treasury indicators and treasury strategy (this report) - the first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);

- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

The approval of the Treasury Management Strategy and Annual Investment Strategy is the function of the Council, however the Head of Corporate Resources shall also report to the Audit Committee on treasury management activity performance as follows:

b. A mid year treasury management report – This will update Members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision. The report will be submitted as soon after 30 September as practically possible.

c. An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy. The report will be submitted no later than 30 September after the financial year end.

1.2.3 Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Committee, which may make recommendations regarding any aspects of treasury management policy and practices it considers appropriate in fulfilment of its scrutiny role. Such recommendations, as may be made shall be incorporated within the above named reports and submitted to meetings of the Council for consideration at the next available opportunity. The Council's Scheme of Delegations is set out in Appendix E.

1.3 Treasury Management Strategy for 2021/22

The strategy for 2021/22 covers two main areas:

Capital issues

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

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

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

1.4 **Training**

The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training. This especially applies to Members responsible for scrutiny. Training was supplied by Link Asset Services on the 2nd July 2019, however it was not possible to arrange a similar event during 2020/21 to date due to the Covid-19 pandemic. Appropriate treasury management training will be provided to the Audit Committee as soon as possible. The training needs of the treasury management officers at Adur District Council, who provide the shared treasury service to Mid Sussex District Council, are periodically reviewed. Officers attend courses provided by appropriate trainers such as CIPFA and Link Asset Services. These courses have been delivered on-line during the Covid-19 period.

1.5 **External Service Providers**

The Council obtains treasury management services under a Shared Services Arrangement (SSA) from the in-house treasury management team formed out of the partnership working between Adur District and Worthing Borough Councils. The operation for all three Councils' treasury management is based at Worthing Town Hall, utilising similar banking arrangements. The SSA is provided under a Service Level Agreement (SLA) that commenced in October 2019 and which defines the respective roles of the client and provider authorities for a period of three years.

The SSA uses Link Group, Treasury Solutions as its external treasury management advisors. The Council recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources.

In making this arrangement the Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that reliance beyond the terms and arrangements specified in the SLA is not placed upon the shared service providers. The Council will ensure that the terms of the appointment of the shared services providers, and the methods by which their value will be assessed, are properly agreed and documented and subjected to regular review.

2. THE CAPITAL PRUDENTIAL INDICATORS 2021/22 – 2023/24

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the Prudential Indicators, which are designed to assist Members' overview and confirm capital expenditure plans.

2.1 **Capital expenditure**

This Prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. The figures exclude other long term liabilities, such as leasing arrangements which already include borrowing instruments. Members are asked to approve the capital expenditure forecasts:

Capital expenditure £m	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
General Fund	9.492	7.981	5.195	1.958	1.080

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

Financing of capital expenditure £m	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Capital receipts	0.086	1.833	2.980	0.050	0.050
Capital grants, Contributions & S106 receipts	6.165	4.530	1.927	1.746	0.900
General Reserves, Specific Reserves & Revenue Contributions	3.241	1.618	0.288	0.162	0.130
Net financing need for the year	0.000	0.000	0.000	0.000	0.000

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

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

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

The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has one finance lease taken out in 2018 and ending in 2028.

The Council is asked to approve the CFR projections below:

Capital Financing Requirement £m	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Total CFR at 31/03	27.438	26.916	26.382	25.835	25.435
Movement in CFR	(0.510)	(0.522)	(0.534)	(0.547)	(0.400)
Movement in CFR represented by:					
Net financing need for the year (above)	0.000	0.000	0.000	0.000	0.000
Less MRP and other financing movements	(0.510)	(0.522)	(0.534)	(0.547)	(0.400)
Movement in CFR	(0.510)	(0.522)	(0.534)	(0.547)	(0.400)

2.3 Minimum revenue provision (MRP) policy statement

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

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

The Council's policy for MRP relating to unfunded capital expenditure is to provide for MRP on an annuity basis over the life of the loans (except as detailed below for the Orchard Shopping Centre). As an annuity is a fixed annual sum comprising interest and principal, the MRP for repayment of debt will increase each year over the asset life as the proportion of interest calculated on the principal outstanding reduces as the debt is repaid.

The purchase of the Orchard Shopping Centre head lease in November 2016 increased the Capital Financing Requirement. However, as the Council is forecasting capital receipts of over £24m, MRP will only be provided on £5m. This will be done on a level basis of £100,000 per year.

2.4 Funds available for investment

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances excluding the investment in the Local Authorities' Property Fund, which the Council views as a long term investment.

Investments	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
	£m	£m	£m	£m
Balance at 1 April	28.465	46.115	39.800	38.792
Capital Expenditure	(7.981)	(5.195)	(1.958)	(1.080)
Grants, capital receipts & other new funds & expenditure	28.053	4.314	1.396	1.251
Loan repayments/adjustments	(2.422)	(5.434)	(0.446)	(0.301)
Balance at 31 March	46.115	39.800	38.792	38.662

3. BORROWING

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

3.1 **Current portfolio position**

The overall treasury management portfolio as at 31 March 2020 and for the position as at 31 December 2020 are shown below for both borrowing and investments.

	Principal at 31.03.20 £m	Actual 31.03.2020 %	Principal at 31.12.20 £m	Actual 31.12.2020 %
External Borrowing				
PWLB	(0.437)	4%	(0.368)	5%
Other Borrowing	(7.000)	70%	(5.000)	65%
Finance lease	(2.541)	26%	(2.330)	30%
TOTAL BORROWING	**(9.978)**	100%	**(7.698)**	100%
Treasury Investments:				
Local Authority Property Fund	5.730	17%	5.730	10%
In-house:				
Banks	5.005	15%	13.999	24%
Building societies - unrated	13.000	38%	17.000	29%
Building societies - rated	1.000	3%	9.000	16%
Local authorities	0.000	0%	2.000	3%
Money market funds	9.460	27%	10.440	18%
TOTAL INVESTMENTS	**34.195**	100%	**58.169**	100%
NET INVESTMENTS	**24.217**		**50.471**	

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

External Debt £m	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Debt at 1 April	13.571	7.437	5.298	0.152	0.000
Expected change in Debt	(6.134)	(2.139)	(5.146)	(0.152)	0.000
Other long-term liabilities (OLTL)	2.818	2.541	2.258	1.970	1.676
Expected change in OLTL	(0.277)	(0.283)	(0.288)	(0.294)	(0.301)
Actual gross debt at 31 March	9.978	7.556	2.122	1.676	1.375
The Capital Financing Requirement	27.438	26.916	26.382	25.835	25.435
Under/(over) borrowing	17.460	19.360	24.260	24.159	24.060

The Council's debt comprises one loan from the Public Works Loan Board (PWLB), which matures on 1 March 2023 and 1 loan with another local authority for £5m, which matures in November 2021 and was arranged to fund the purchase of the Orchard Shopping Centre head lease. The local authority loan is at a rate (1.3%) lower than those that were available from the PWLB and it will be repaid using capital receipts and maturing investments. The "other long term liability" is in respect of capital assets acquired by finance leases.

Within the range of Prudential Indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Head of Corporate Resources reports that the Council complied with this Prudential Indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this report.

3.2 **Treasury Indicators: limits to borrowing activity**

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

Operational Boundary	2020/21	2021/22	2022/23	2023/24
	£m	**£m**	**£m**	**£m**
Debt	£28.0m	£28.0m	£28.0m	£28.0m
Other long term liabilities	£4.0m	£4.0m	£4.0m	£4.0m
Total	**£32.0m**	**£32.0m**	**£32.0m**	**£32.0m**

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

1. The Council is asked to approve the authorised limit:

Authorised Limit	2020/21	2021/22	2022/23	2023/24
	£m	**£m**	**£m**	**£m**
Debt	£30.0m	£30.0m	£30.0m	£30.0m
Other long term liabilities	£4.0m	£4.0m	£4.0m	£4.0m
Total	**£34.0m**	**£34.0m**	**£34.0m**	**£34.0m**

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

The Head of Corporate Resources has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Council at the earliest opportunity.

3.3 Prospects for interest rates

The Council's shared service provider uses Link Group as its treasury advisor. Link has provided the following forecast for the certainty interest rate (gilt yield plus 80bps):

Link Group Interest Rate View 9.11.20													
These Link forecasts have been amended for the reduction in PWLB margins by 1.0% from 26.11.20													
	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
BANK RATE	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
3 month ave earnings	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
6 month ave earnings	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
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
5 yr PWLB	0.80	0.80	0.80	0.80	0.90	0.90	0.90	0.90	0.90	1.00	1.00	1.00	1.00
10 yr PWLB	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.20	1.30	1.30	1.30	1.30
25 yr PWLB	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80	1.80	1.80	1.80
50 yr PWLB	1.30	1.40	1.40	1.40	1.40	1.50	1.50	1.50	1.50	1.60	1.60	1.60	1.60

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to January 2021, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the near-term as economic recovery is expected to be only gradual and, therefore, prolonged. These forecasts were based on an assumption that a Brexit trade deal would be agreed by 31.12.20: as this has now occurred, these forecasts do not need to be revised.

Gilt yields / PWLB rates

There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was a heightened expectation that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March 2020. After gilt yields spiked up during the financial crisis in March, we have seen these yields fall sharply to unprecedented lows as investors panicked during March in selling shares in anticipation of impending recessions in western economies, and moved cash into safe haven assets i.e. government bonds. However, major western central banks took rapid action to deal with excessive stress in financial markets during March, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and

quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in “normal” times would have caused bond yields to rise sharply. Gilt yields and PWLB rates have been at remarkably low rates so far during 2020/21.

As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

Investment and borrowing rates

- **Investment returns** are likely to remain exceptionally low during 2021/22 with little increase in the following two years.

- **Borrowing interest rates** fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England: indeed, gilt yields up to 6 years were negative during most of the first half of 20/21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. The unexpected increase of 100bps in PWLB rates on top of the then current margin over gilt yeilds of 80bps in October 2019, required an initial major rethink of local authority treasury management strategy and risk management. However, in March 2020, the Government started a consultation process for reviewing the margins over gilt rates for PWLB borrowing for different types of local authority capital expenditure.

- As a consequence of these increases in margins, many local authorities decided to refrain from PWLB borrowing unless it was for HRA or local infrastructure financing, until such time as the review of margins was concluded.

- On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital programme. The new margins over gilt yields are as follows: -.

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB Certainty Rate** is gilt plus 80 basis points (G+80bps)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB HRA Certainty Rate** is gilt plus 80bps (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60bps (G+60bps)

- **Borrowing for capital expenditure** As Link’s long-term forecast for Bank Rate is 2.00%, and all PWLB rates are under 2.00%, there is now value in borrowing from the PWLB for all types of capital expenditure for all maturity periods, especially as current rates are at historic lows. However, greater value can be obtained in borrowing for shorter maturity periods so, if borrowing is required, the Council will assess its risk appetite in conjunction with budgetary pressures to reduce total interest costs.

- This authority does not plan any borrowing to finance new capital expenditure, or to replace maturing debt. If borrowing **is** undertaken there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

3.4 **Borrowing strategy**

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

Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 treasury operations. The Head of Corporate Resources will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there is a significant risk of a sharp FALL in borrowing rates, then borrowing, if required, will be postponed.

- if it was felt that there is a significant risk of a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. As stated, there are no current plans to borrow, but if this changes, it is most likely that fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

3.5 **Policy on borrowing in advance of need**

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism

3.6 **Debt rescheduling**

The Council has one loan from the Public Works Loan Board, repaid by fixed annuities over the life of the loan. As it would not be possible to prematurely repay the existing loan without incurring a premium charge for early settlement, there is currently no intention to redeem the loan early. The loan for the purchase of the Orchard Shopping Centre head lease will be repaid in November 2021. Any rescheduling will be reported to the Council at the earliest meeting following its action.

3.7 **New financial institutions as a source of borrowing and / or types of borrowing**

Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and non-HRA borrowing. However, if borrowing is required, consideration may still need to be given to sourcing funding from the following sources for the following reasons:

- Local authorities (primarily shorter dated maturities out to 3 years or so – still cheaper than the Certainty Rate).
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a "cost of carry" or to achieve refinancing certainty over the next few years).
- Municipal Bonds Agency (possibly still a viable alternative depending on market circumstances prevailing at the time).

Our advisors will keep us informed as to the relative merits of each of these alternative funding sources if any borrowing is required.

4. ANNUAL INVESTMENT STRATEGY

4.1 Investment policy – management of risk

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

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

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

The Head of Corporate Resources, under delegated powers, will undertake through the Shared Service Arrangement the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements, and Prudential Indicators. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the Council will also consider the value available in periods up to 12 months with high credit rated financial institutions, as well as wider range fund options. As conditions in the financial markets remain uncertain, the proposed Specified and Unspecified investments will remaing the same as for 2020/21 except for:

(i) Appendix D details the criteria for non-specified investments. Deposits with banks, building societies and local authorities currently are within one category with a maximum total limit of 50% of funds. Local authorities will be given a separate limit to allow flexibility to enable the service to take advantage of the best investment returns based on the liquidity needs of the Council

(ii) Al Rayan Bank will be added to the specified investments in Appendix C, with a maximum investment duration of 1 year. Al Rayan Bank is the UK's oldest and largest Sharia compliant retail bank and has a current credit rating of A1 from the rating agency Moodys. It operates an ethical model which excludes non-Sharia compliant investments such as in gambling, alcohol, pornography, tobacco and arms.

Investment instruments identified for use in the financial year are listed in Appendices C and D under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices.

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

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

2. **Other information**: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

3. **Other information sources** used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. This authority has defined the list of **types of investment instruments** that the treasury management team is authorised to use. There are two lists in Appendices C and D under the categories of 'specified' and 'non-specified' investments.

    - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity if originally they were classified as being non-specified investments solely due to the maturity period exceeding one year.
    - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. The Council has set limits on the maximum exposure of the total treasury management investment portfolio to categories of non-specified treasury management investments.

5. **Lending limits**, (amounts and maturity), for each counterparty are set out in Appendices C and D.

6. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 4.8).

7. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 4.5). The UK is excluded from this limit because it will be necessary to invest in UK banks and other institutions even if the sovereign rating is cut.

8. Through the shared service, this authority has access to **external consultants**, to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

9. All investments will be denominated in **sterling**.

10. As a result of the change in accounting standards for 2020/21 under **IFRS 9**, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31 March 2023. Consequently any fluctuations in the value of the Council's investment in the Local Authorities' Property Fund will not be taken through the general fund for the period of the override.

    However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.14). Regular monitoring of investment performance will be carried out during the year.

    Changes in risk management policy from last year

    The above criteria are unchanged from last year other than the changes set out in 4.1.

4.2 **Creditworthiness policy**

The primary principle governing the Council's investment criteria through the Shared Services Arrangement (SSA) is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the SSA will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring

their security. This is set out in the specified and non-specified investment sections in Appendices C and D; and

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's Prudential Indicators covering the maximum principal sums invested.

The SSA will maintain a counterparty list in compliance with the criteria in the Appendices and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied to the SSA by the Link Group, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of the longer term bias outside the central rating view) are provided to the SSA almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

Use of additional information other than credit ratings

Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information will be applied to compare the relative security of differing investment opportunities.

The officers of the shared service recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets, the government support for banks, and the credit ratings of that government support. Accordingly, the shared service will exercise discretion to deviate from Link's suggested durational bands – for example the Council approves the use of Building Societies as set out in the Appendices.

4.3 **Creditworthiness**

Although the credit rating agencies changed their outlook on many UK banks from Stable to Negative during the quarter ended 30.6.20 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of major financial institutions, including UK banks. However, during Q1 and Q2 2020, banks made provisions for *expected* credit losses and the rating changes reflected these provisions. As we move into future quarters, more information will emerge on *actual* levels of credit losses. (Quarterly earnings reports are normally announced in the second half of the month following the end of the quarter.) This has the potential to cause rating agencies to revisit their initial rating adjustments earlier in the current year. These adjustments could be negative or positive, although it should also be borne in mind that banks went into this pandemic with strong balance sheets. This is predominantly a result of regulatory changes imposed on banks following the Great Financial Crisis. Indeed, the Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the UK banking sector to "somewhat less than £80bn". It stated that in its assessment, "banks have buffers of capital more than sufficient to absorb the losses that

are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%. All three rating agencies have reviewed banks around the world with similar results in many countries of most banks being placed on Negative Outlook, but with a small number of actual downgrades.

CDS prices
Although bank CDS prices (these are market indicators of credit risk) spiked upwards at the end of March / early April 2020 due to the heightened market uncertainty and ensuing liquidity crisis that affected financial markets, they have returned to more average levels since then. Nevertheless, prices are still elevated compared to end-February 2020. Pricing is likely to remain volatile as uncertainty continues. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Council has access to this information via its Link-provided Passport portal.

4.4 **The Council's Minimum Investment Creditworthiness Criteria**

The minimum credit ratings criteria used by the Council generally will be a short term rating (Fitch or equivalents) of F1, and long term rating A-. There may be occasions when the counterparty ratings from one or more of the three Ratings Agencies are marginally lower than the minimum requirements of F1 Short term, A- Long term (or equivalent). Where this arises, the counterparties to which the ratings apply may still be used with discretion, but in these instances consideration will be given to the whole range of topical market information available, not just ratings.

The Council includes **Building Societies** with asset size in excess of £1 billion in its approved counterparty list. It is recognised that they may carry a lower credit rating than the Council's other counterparties, or no rating, therefore the lending limits for the building societies shall be £4m each for the top 3 and £3m for the others.

4.5 **Other limits**

Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors. The shared service has determined that it will only use approved counterparties from countries (other than the UK) with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide one). The list of countries that qualify using these credit criteria as at the date of this report is reflected in the counterparty approved lending list at Appendix C. This list will be added to, or deducted from, by officers should ratings change, in accordance with this policy. No more than 25% of investments shall be placed in non-UK financial institutions for more than 7 days.

4.6 **Investment strategy**

In-house funds - Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed. For cash flow balances, the shared service will seek to use notice accounts, money market funds and short-dated deposits to benefit from the compounding of interest

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.

- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

The Head of Corporate Resources, through the shared service, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to the meetings of the Audit Committee and the Council in accordance with the reporting arrangements. The shared service will take into account the ethical, social or climate change policies of counterparties.

Investment returns expectations

Bank Rate is unlikely to rise from 0.10% for a considerable period. It is very difficult to say when it may start rising so it may be best to assume that investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows (the long term forecast is for periods over 10 years in the future):

Average earnings in each year	
2020/21	0.10%
2021/22	0.10%
2022/23	0.10%
2023/24	0.10%
2024/25	0.25%
Long term later years	2.00%

- The overall balance of risks to economic growth in the UK is probably now skewed to the upside, but is subject to major uncertainty due to the virus and how quickly successful vaccines may become widely administered to the population. It may also be affected by the operation of the deal the UK agreed as part of Brexit.

- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, or a return of investor confidence in equities, could impact gilt yields, (and so PWLB rates), in the UK.

4.7 **Negative investment rates**

While the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, and in November omitted any mention of negative rates in the minutes of the meeting of the Monetary Policy Committee, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the COVID crisis; this has caused some local authorities to have sudden large increases in cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

As for money market funds (MMFs), yields have continued to drift lower. Some managers have already resorted to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a surfeit of money swilling

around at the very short end of the market. This has seen a number of market operators, now including the DMADF, offer nil or negative rates for very short term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions for investments at the very short end of the yield curve.

Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

4.8 **Investment treasury indicator and limit - principal funds invested for greater than 365 days**
These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end. There are currently no fixed term deposit investments with a remaining duration of more than 365 days, although the Local Authorities' Property Fund investment of £6m is expected to be held for more than 365 days.

The Council is asked to approve the following treasury indicator limit: -

Maximum proportion of principal sums invested > 365 days	2021/22	2022/23	2023/24
Principal sums invested > 365 days	50%	50%	50%

4.9 In any sustained period of significant stress in the financial markets, the default position is for investments to be placed with The Debt Management Account Deposit Facility of the Debt Management Office (DMO) of the UK central government. The rates of interest are below equivalent money market rates, however, the returns are an acceptable trade-off for the guarantee that the Council's capital is secure.

4.10 The Council's proposed investment activity for placing cash deposits in 2020/21 will be to use:

- AAA rated Money Market Funds with a Constant Net Asset Value (CNAV) or a Low Volatility Net Asset Value (LVNAV) under the new money market fund regulations
- other local authorities, parish councils etc.
- bank business reserve accounts and term deposits. These are primarily restricted to UK institutions that are rated at least A- long term.
- Building Societies with asset size in excess of £1 billion

4.11 **Other Options for Longer Term Investments**

To provide the Council with options to enhance returns above those available for short term durations, it is proposed to retain the option to use the following for longer term investments, as an alternative to cash deposits:

a) **Supranational bonds** greater than 1 year to maturity

b) **Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.

c) **Building Societies** not meeting the basic security requirements under the specified investments, but on the list in Appendix C (b). The operation of some building societies

does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings.

d) Any **bank** that has a minimum long term credit rating of A- for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).

e) Any **non-rated subsidiary** of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to a guarantee from the parent company, and exposure up to the limit applicable to the parent.

g) **Property Investment Funds** for example the Local Authorities' Property Fund. The Councils will consult the Treasury Management Advisors and undertake appropriate due diligence before investment of this type is undertaken. Some of these funds are deemed capital expenditure – the Councils will seek guidance on the status of any fund considered for investment.

h) Other **local authorities**, parish councils etc.

i) Other investments listed in Appendices C and D - the Council will seek further advice on the appropriateness and associated risks with investments in these other categories as and when an opportunity presents itself.

4.12 The **accounting treatment** may differ from the underlying cash transactions arising from investment decisions made by the Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, the accounting implications of new transactions will be reviewed before they are undertaken.

4.13 The Council will not transact in any investment that may be deemed to constitute capital expenditure (e.g. Share Capital, or pooled investment funds other than Money Market Funds), without the resource implications being approved as part of the consideration of the Capital Programme or other appropriate Committee report.

4.14 **Investment risk benchmarking** – The shared service will subscribe to Link's Investment Benchmarking Club to review the investment performance and risk of the portfolios.

4.15 At the end of the financial year the Council will report on investment activity as part of the **Annual Treasury Report.**

4.16 **External fund managers**
The Council does not use external fund managers, (other than the Local Authorities' Property Fund) but reserves the option to do so in future should this be deemed to be appropriate. Should consideration be given to exercising this option in the future, the relevant Committee will be advised of the reasons for doing so and the Council requested to consider whether it wishes to proceed with the selection and appointment of external fund managers.

4.17 **The monitoring of investment counterparties –** The credit rating of counterparties will be monitored regularly. The shared service receives credit rating information (changes, rating watches and rating outlooks) from Link Group as and whent ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the shared service, and if required, new counterparties which meet the criteria will be added to the list.

Officers of the shared service met in September 2020 with representatives of the Local Authorities' Property Fund for a presentation on the activity and outlook of the Fund to supplement the regular reports and dividend statements.

Appendix A

THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2021/22 – 2023/24

1.1 The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the Prudential Indicators, which are designed to assist Members' overview and confirm capital expenditure plans.

Capital expenditure	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
	£m	**£m**	**£m**	**£m**	**£m**
General Fund	9.492	7.981	5.195	1.958	1.080

1.2 **Affordability Prudential Indicators**

The previous sections cover the overall capital and control of borrowing Prudential Indicators, but within this framework Prudential Indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2019/20 Actual	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
	%	**%**	**%**	**%**	**%**
Ratio	0.32%	1.37%	1.06%	0.98%	0.20%

The estimates of financing costs include current commitments and the proposals in this budget report.

1.3 **Maturity structure of borrowing**

These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits. However as the Council currently has only two significant loans, the upper limits need to be set very high. The Council does not have any variable rate borrowing.

The Council is asked to approve the following treasury indicators and limits:

Maturity structure of fixed interest rate borrowing 2021/22		
	Lower	**Upper**
Under 12 months	0%	80%
12 months to 2 years	0%	70%
2 years to 5 years	0%	80%
5 years to 10 years	0%	80%
Over 10 years	0%	60%

Appendix B

TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

The MHCLG issued Investment Guidance in 2018, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, which will apply to all investment activity. In accordance with the Code, the Council will comply with the treasury management practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

Annual investment strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of the annual treasury strategy for the following year, covering the identification and approval of the following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

Strategy guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

SPECIFIED AND NON SPECIFIED INVESTMENTS

A variety of investment instruments will be used , subject to the credit quality of the institution and, depending on the trype of investment made, it will fall into one the categories below.

Specified Investments will be those that meet the criteria in the MHCLG Guidance, i.e. the investment

- is sterling denominated

- has a maximum maturity of 1 year or where the Council has the right to be repaid within 12 months or where the investment would have been classified as specified apart from originally being for a period longer than 12 months, once the remaining period to maturity falls to under 12 months

- meets the "high" credit criteria as determined by the Council or is made with the UK government or is made with a local authority in England, Wales and Scotland

- the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

These are considered low risk assets where the possibility of loss of principal or investment income is small.

"Specified" Investments identified for the Council's use are:

- The UK Government such as the Debt Management Account deposit facility
- Deposits with UK local authorities
- Deposits with banks and building societies
- *Certificates of deposit with banks and building societies
- *Gilts : (bonds issued by the UK government)
- *Bonds issued by multilateral development banks
- Pooled investment vehicles such as AAA Money Market Funds with a Constant Net Asset Value (Constant NAV) or appropriate Low Volatility Net Asset Value (LVNAV) that have been awarded an AAA rating by Standard and Poor's, Moody's and/or Fitch rating agencies.
- Other Money Market Funds and Collective Investment Schemes– i.e. credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

* Investments in these instruments will be on advice from the Shared Service's treasury advisor.

For credit rated counterparties, the minimum criteria, excepting for the Council's own banker and the specified building societies, (see below) will be the short-term / long-term ratings assigned by various agencies which may include Moody's Investors Services, Standard and Poor's, Fitch Ratings, being:

Long-term investments (over 365 days): minimum: A- (Fitch) or equivalent
Or
Short-term investments (365 days or less): minimum: F1 (Fitch) or equivalent

For all investments the Shared Service will also take into account information on corporate developments of, and market sentiment towards, investment counterparties.

If the Council's own banker (currently Lloyds Bank) falls beneath the specified criteria, it will still be used for transactional purposes.

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies, as detailed below.

Non Specified Investments

These are any investments which do not meet the specified investment criteria.

APPENDIX C

APPROVED INVESTMENT INSTITUTIONS

Specified Investments identified for use by the Council

New specified investments will be made within the following limits:

(a) Banks

Major U.K. and European Banks and their wholly-owned subsidiaries meeting the Council's approved investment criteria. RFB refers to Ring Fenced Bank – the separate core retail banking service.

	Counterparty	Group	Maximum Sum	Maximum Period *
1	HSBC UK Bank PLC (RFB)	N/A	£4m	5 years
2	The Royal Bank of Scotland Group:	£5m		
	The Royal Bank of Scotland PLC (RFB)		£4m	5 years
	National Westminster Bank PLC (RFB)		£4m	5 years
3	Lloyds Group::	£5m		
	Lloyds Bank PLC (RFB)		£4m	5 years
	Bank of Scotland PLC (RFB)		£4m	5 years
4	Barclays Bank UK PLC (RFB)	N/A	£4m	5 years
5	Santander UK PLC	N/A	£4m	5 years
6	Clydesdale Bank PLC	N/A	£4m	5 years
7	Handelsbanken PLC	N/A	£4m	1 year
8	Goldman Sachs International Bank	N/A	£4m	5 years
9	Close Brothers Ltd	N/A	£4m	5 years
10	Al Rayan Bank Plc	N/A	£3m	1 year

*Specified investments are for a maximum period of 1 year, the maximum limits shown in this column are for non-specified investments with these institutions.

(b) Building Societies

Building Societies (Assets in excess of £1 billion):

Rank	Name of Counterparty	Individual	
		Sum	Period*
1	Nationwide	£4m	3 years
2	Coventry	£4m	3 years
3	Yorkshire	£4m	3 years
4	Skipton	£3m	3 years
5	Leeds	£3m	3 years
6	Principality	£3m	3 years
7	West Bromwich	£3m	3 years
8	Newcastle	£3m	3 years
9	Nottingham	£3m	3 years
10	Cumberland	£3m	3 years
11	National Counties (Family)	£3m	3 years
12	Progressive	£3m	3 years
13	Cambridge	£3m	3 years
14	Monmouthshire	£3m	3 years
15	Newbury	£3m	3 years
16	Leek United	£3m	3 years
17	Saffron	£3m	3 years

(c) Money Market Funds

Counterparty	Sum	
Invesco Aim – Sterling	£3m	For Short Term Operational Cash Flow Purposes
Blackrock Institutional Sterling Liquidity Fund	£3m	
Goldman Sachs Sterling Liquidity Reserve Fund	£3m	
Fidelity Institutional Cash Fund plc – Sterling	£3m	
CCLA Public Sector Deposit Fund	£3m	
JP Morgan GBP Liquidity LVNAV Fund	£3m	
Federated Short-Term Sterling Prime Liquidity Fund	£3m	

The limit for investing in any one Money Market Fund is £3 million. Total investments in Money Market Funds shall not exceed the higher of £9m or 25% of the total investment portfolio, for more than one week at any one time.

(d) Local Authorities

Details	Individual	
	Sum	Period*
All Local Authorities	£3m	5 years

*Specified investments are for a maximum period of 1 year, the maximum period limits shown in (b) and (d) are for non-specified investments with these institutions.

APPENDIX D

NON-SPECIFIED INVESTMENTS DETERMINED FOR USE BY THE COUNCIL

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Council's use.

	In-house use	Use by Fund Managers	Maximum Maturity	Maximum % of portfolio or £m	Capital Expenditure?
• Deposits with banks and building societies and • Certificates of deposit with banks and building societies	√ √	 √	5 years	The higher of £10m or 50% of funds	No
• Deposits with Local Authorities	√		5 years	The higher of £10m or 50% of funds	No
Gilts and Bonds: • Gilts • Bonds issued by multilateral development banks • Bonds issued by financial institutions guaranteed by the UK government • Sterling denominated bonds by non-UK sovereign governments	√ √ √ √ (on advice from treasury advisor)	√ √ √ √	5 years	The higher of £3m or 25% of funds	No
Money Market Funds and Collective Investment Schemes (pooled funds which meet the definition of a collective investment scheme as defined in SI 2004 No. 534 and SI 2007, No. 573), but which are not credit rated.	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date.	The higher of £9m or 25% of funds	No
Government guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	√ (on advice from treasury advisor)	√	5 years	The higher of £2m or 10% of funds	Subject to test
Property Funds approved by HM Treasury and operated by managers regulated by the Financial Conduct Authority – specifically the Local Authorities' Property Fund	√	√	These funds do not have a defined maturity date.	The higher of £6m or 25% of funds	No
Non-guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	√ (on advice from treasury advisor)	√	5 years	The higher of £2m or 10% of funds	Subject to test
Collective Investment Schemes (pooled funds) which do not meet the definition of collective investment schemes in SI 2004 No. 534 or SI 2007, No. 573.	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date	The higher of £2m or 20% of funds	Subject to test

In determining the period to maturity of an investment, the investment is regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.

The Council will seek further advice on the appropriateness and associated risks with investments in these Non-Specified investment categories, other than those which would be Specified other than for the duration of over 12 months (for example a 2 year fixed term deposits with a bank on the counterparty list).

Accounting treatment of investments

The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

The monitoring of investment counterparties - The credit rating of counterparties will be monitored regularly. The Council's Shared Service receives credit rating information (changes, rating watches and rating outlooks) from Link as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Shared Service, and if required new counterparties which meet the criteria will be added to the list.

APPENDIX E

TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) **Full Council**

- approval of annual treasury management strategy and Annual Investment Strategy
- approval of MRP Statement

(ii) **Executive Committee (e.g. Cabinet)**

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

(iii) **Audit Committee**

Receiving and reviewing the following, and making recommendations to the Cabinet

- regular monitoring reports on compliance with the Treasury Management Strategy, practices and procedures.

(iv) **The S151 (responsible) officer**

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

APPENDIX F

ECONOMIC BACKGROUND supplied by Link Group

- **UK.** The key quarterly meeting of the Bank of England Monetary Policy Committee kept **Bank Rate** unchanged on 5.11.20. However, it revised its economic forecasts to take account of a second national lockdown from 5.11.20 to 2.12.20 which is obviously going to put back economic recovery and do further damage to the economy. It therefore decided to do a further tranche of **quantitative easing (QE) of £150bn**, to start in January when the current programme of £300bn of QE, announced in March to June, runs out. It did this so that "announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target".
- Its forecasts appeared, at that time, to be rather optimistic in terms of three areas:
    - The economy would recover to reach its pre-pandemic level in Q1 2022
    - The Bank also expected there to be excess demand in the economy by Q4 2022.
    - CPI inflation was therefore projected to be a bit above its 2% target by the start of 2023 and the "inflation risks were judged to be balanced".
- Significantly, there was no mention of **negative interest rates** in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 months. However, rather than saying that it "stands ready to adjust monetary policy", the MPC this time said that it will take "whatever additional action was necessary to achieve its remit". The latter seems stronger and wider and may indicate the Bank's willingness to embrace new tools.
- One key addition to **the Bank's forward guidance in August** was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. Our Bank Rate forecast currently shows no increase, (or decrease), through to quarter 1 2024 but there could well be no increase during the next five years as it will take some years to eliminate spare capacity in the economy, and therefore for inflationary pressures to rise to cause the MPC concern. **Inflation** is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short lived factor due to base effects from twelve months ago falling out of the calculation, and so is not a concern. Looking further ahead, it is also unlikely to be a problem for some years as it will take a prolonged time for spare capacity in the economy, created by this downturn, to be used up.

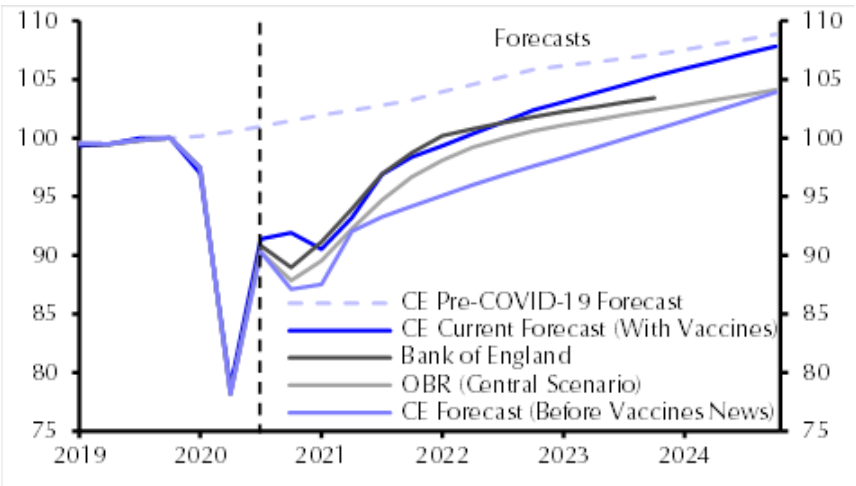
- **Public borrowing** was forecast in November by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the government will still be running a budget deficit of £102bn (3.9% of GDP) by 2025/26. However, initial impressions are that they have taken a pessimistic view of the impact that vaccines could make in the speed of economic recovery.

- Overall, **the pace of recovery** was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp after quarter 1 saw growth at -3.0% followed by -18.8% in quarter 2 and then an upswing of +16.0% in quarter 3; this still left the economy 8.6% smaller than in Q4 2019. While the one month second national lockdown that started on 5th November caused a further contraction of 5.7% m/m in November, this was much better than had been feared and showed that the economy is adapting to new ways of working. This left the economy 'only' 8.6% below the pre-crisis level.

- **Vaccines – the game changer.** The Pfizer announcement on 9th November of a successful vaccine has been followed by approval of the Oxford University/AstraZeneca and Moderna vaccines. The Government has a set a target to vaccinate 14 million people in the most at risk sectors of the population by 15th February; as of mid-January, it has made good, and accelerating progress in hitting that target. The aim is to vaccinate all adults by September. This means that the national lockdown starting in early January, could be replaced by regional tiers of lighter restrictions, beginning possibly in Q2. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines have radically improved the economic outlook so that it may now be possible for GDP to recover to its pre-virus level as early as Q1 2022. These vaccines have enormously boosted confidence that **life could largely return to normal during the second half of 2021**. With the household saving rate having been exceptionally high since the first lockdown in March, there is plenty of pent-up demand and purchasing power stored up for when life returns to normal.

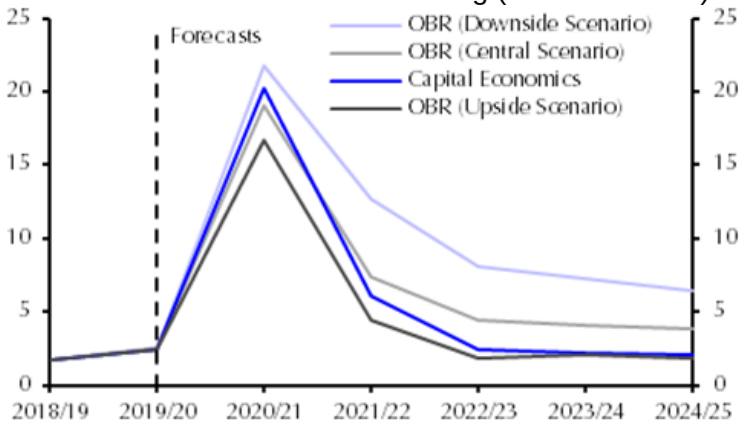
- Provided that both monetary and fiscal policy are kept loose for a few years yet, then it is still possible that in the second half of this decade, the economy may be no smaller than it would have been if COVID-19 never happened. The significant risk is if another mutation of COVID-19 appears that defeats the current batch of vaccines. However, now that science and technology have caught up with understanding this virus, new vaccines ought to be able to be developed more quickly to counter such a development, and vaccine production facilities are being ramped up around the world.

Chart: Level of real GDP (Q4 2019 = 100)



This recovery of growth which eliminates the effects of the pandemic by about the middle of the decade, would have major repercussions for public finances as it would be consistent with the government deficit falling to around 2.5% of GDP without any tax increases. This would be in line with the OBR's most optimistic forecast in the graph below, rather than their current central scenario which predicts a 4% deficit due to assuming much slower growth. However, Capital Economics forecasts assumed that politicians do not raise taxes or embark on major austerity measures and so, (perversely!), depress economic growth and recovery.

Chart: Public Sector Net Borrowing (as a % of GDP)



- There will still be some **painful longer term adjustments** as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever, even if vaccines are fully successful in overcoming the current virus. There is also likely to be a **reversal of globalisation** as this crisis has exposed how vulnerable long-distance supply chains are. On the other hand, **digital services** are one area that has already seen huge growth.

- **Brexit.** The final agreement of a trade deal on 24.12.20 has eliminated a significant downside risk for the UK economy. The initial agreement only covers trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. As the forecasts in this report were based on an assumption of a Brexit agreement being reached, there is no need to amend these forecasts.

- **Monetary Policy Committee meeting of 17 December.** All nine Committee members voted to keep interest rates on hold at +0.10% and the Quantitative Easing (QE) target at £895bn. The MPC commented that the successful rollout of vaccines had reduced the downsides risks to the economy that it had highlighted in November. But this was caveated by it saying, "Although all members agreed that this would reduce downside risks, they placed different weights on the degree to which this was also expected to lead to stronger GDP growth in the central case." So, while vaccines are a positive development, in the eyes of the MPC at least, the economy is far from out of the woods in the shorter term. The MPC, therefore, voted to extend the availability of the Term Funding Scheme, (cheap borrowing), with additional incentives for small and medium size enterprises for six months from 30.4.21 until 31.10.21. (The MPC had assumed that a Brexit deal would be agreed.)

- **Fiscal policy.** In the same week as the MPC meeting, the Chancellor made a series of announcements to provide further support to the economy: -
  - An extension of the COVID-19 loan schemes from the end of January 2021 to the end of March.
  - The furlough scheme was lengthened from the end of March to the end of April.
  - The Budget on 3.3.21 will lay out the "next phase of the plan to tackle the virus and protect jobs". This does not sound like tax rises are imminent, (which could hold back the speed of economic recovery).

- The **Financial Policy Committee** (FPC) report on 6.8.20 revised down their expected credit losses for the banking sector to "somewhat less than £80bn". It stated that in its assessment, "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

- **US.** The Democrats gained the presidency and a majority in the House of Representatives in the November elections: after winning two key Senate seats in Georgia in elections in early January, they now also have a very slim majority in the Senate due to the vice president's casting vote. President Biden will consequently have a much easier path to implement his election manifesto. However, he will not have a completely free hand as more radical Democrat plans may not be supported by all Democrat senators. His initial radical plan for a fiscal stimulus of $1.9trn, (9% of GDP), is therefore likely to be toned down in order to get through both houses.

- **The economy** had been recovering quite strongly from its contraction in 2020 of 10.2% due to the pandemic with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during quarter 4, to the highest level since mid-August, suggests that the US could be in the early stages of a fourth wave. The latest upturn poses a threat that the recovery in the economy could stall. This is **the single biggest downside risk** to the shorter term outlook – a more widespread and severe wave of infections over the winter months, which is compounded by the impact of the regular flu season and, as a consequence, threatens to overwhelm health care facilities. Under those circumstances, individual states might feel it necessary to return to more draconian lockdowns.

- The restrictions imposed to control the spread of the virus are once again weighing on the economy with employment growth slowing sharply in November and declining in December, and retail sales dropping back. The economy is set for further weakness into the spring. **GDP growth** is expected to rebound markedly from the second quarter of 2021 onwards as vaccines are rolled out on a widespread basis and restrictions are loosened.

- After Chair Jerome Powell unveiled the **Fed's adoption of a flexible average inflation target** in his Jackson Hole speech in late August 2020, the mid-September meeting of the Fed agreed by a majority to a toned down version of the new inflation target in his speech - that *"it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time."* This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary "trap" like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. The FOMC's updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

- The Fed's meeting on **5 November** was unremarkable - but at a politically sensitive time around the elections. At its **16 December** meeting the Fed tweaked the guidance for its monthly asset quantitative easing purchases with the new language implying those purchases could continue for longer than previously believed. Nevertheless, with officials still projecting that **inflation** will only get back to 2.0% in 2023, the vast majority expect the Fed funds rate to be still at near-zero until 2024 or later. Furthermore, officials think the balance of risks surrounding that median inflation forecast are firmly skewed to the downside. The key message is still that policy will remain unusually accommodative – with near-zero rates and asset purchases – continuing for several more years. This is likely to result in keeping Treasury yields low – which will also have an influence on gilt yields in this country.

- **EU.** In early December, the figures for Q3 GDP confirmed that the economy staged a rapid rebound from the first lockdowns. This provides grounds for optimism about growth prospects for next year. In Q2, GDP was 15% below its pre-pandemic level. But in Q3 the economy grew by 12.5% q/q leaving GDP down by "only" 4.4%. That was much better than had been expected earlier in the year. However, growth is likely to stagnate during Q4 and in Q1 of 2021, as a second wave of the virus has seriously affected many countries. The €750bn fiscal support package

eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support, and quickly enough, to make an appreciable difference in the countries most affected by the first wave.

- With **inflation** expected to be unlikely to get much above 1% over the next two years, **the ECB** has been struggling to get inflation up to its 2% target. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the ECB has stated that it retains this as a possible tool to use. The ECB's December meeting added a further €500bn to the PEPP scheme, (purchase of government and other bonds), and extended the duration of the programme to March 2022 and re-investing maturities for an additional year until December 2023. Three additional tranches of TLTRO, (cheap loans to banks), were approved, indicating that support will last beyond the impact of the pandemic, implying indirect yield curve control for government bonds for some time ahead. The Bank's forecast for a return to pre-virus activity levels was pushed back to the end of 2021, but stronger growth is projected in 2022. The total PEPP scheme of €1,850bn of QE which started in March 2020 is providing protection to the sovereign bond yields of weaker countries like Italy. There is therefore unlikely to be a euro crisis while the ECB is able to maintain this level of support. However, as in the UK and the US, the advent of highly effective vaccines will be a game changer, although growth will struggle before later in quarter 2 of 2021.

- **China.** After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and then into Q3 and Q4; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth. At the same time, China's economy has benefited from the shift towards online spending by consumers in developed markets. These factors help to explain its comparative outperformance compared to western economies. However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns in the longer term. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

- **Japan.** A third round of fiscal stimulus in early December took total fresh fiscal spending this year in response to the virus close to 12% of pre-virus GDP. That's huge by past standards, and one of the largest national fiscal responses. The budget deficit is now likely to reach 16% of GDP this year. Coupled with Japan's relative success in containing the virus without draconian measures so far, and the likelihood of effective vaccines being available in the coming months, the government's latest fiscal effort should help ensure a strong recovery and to get back to pre-virus levels by Q3 2021 – around the same time as the US and much sooner than the Eurozone.

- **World growth.** World growth will has been in recession in 2020 and this is likely to continue into the first half of 2021 before recovery in the second half. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

- Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse

to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation.

Summary

Central banks are, therefore, likely to support growth by maintaining loose monetary policy through keeping rates very low for longer. Governments could also help a quicker recovery by providing more fiscal support for their economies at a time when total debt is affordable due to the very low rates of interest. They will also need to avoid significant increases in taxation or austerity measures that depress demand and the pace of recovery in their economies.

If there is a huge surge in investor confidence as a result of successful vaccines which leads to a major switch out of government bonds into equities, which, in turn, causes government debt yields to rise, then there will be pressure on central banks to actively manage debt yields by further QE purchases of government debt; this would help to suppress the rise in debt yields and so keep the total interest bill on greatly expanded government debt portfolios within manageable parameters. It is also the main alternative to a programme of austerity.

INTEREST RATE FORECASTS

Brexit. The interest rate forecasts provided by Link in paragraph 3.3 were predicated on an assumption of a reasonable agreement being reached on trade negotiations between the UK and the EU by 31.12.20. There is therefore no need to revise these forecasts now that a trade deal has been agreed. Brexit may reduce the economy's potential growth rate in the long run. However, much of that drag is now likely to be offset by an acceleration of productivity growth triggered by the digital revolution brought about by the COVID crisis.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably now skewed to the upside, but is still subject to some uncertainty due to the virus and the effect of any mutations, and how quick vaccines are in enabling a relaxation of restrictions.
- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.

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

- **UK government** takes too much action too quickly to raise taxation or introduce austerity measures that depress demand and the pace of recovery of the economy.
- **UK - Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis.** The ECB has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for "weaker" countries. In addition, the EU agreed a €750bn fiscal support package. These actions will help shield weaker economic regions for the next two or three years. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to GDP and annual balanced budgets and southern countries who want to see jointly

issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.

- Weak capitalisation of some **European banks**, which could be undermined further depending on extent of credit losses resultant of the pandemic.
- **German minority government & general election in 2021.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Angela Merkel has stepped down from being the CDU party leader but she will remain as Chancellor until the general election in 2021. This then leaves a major question mark over who will be the major guiding hand and driver of EU unity when she steps down.
- **Other minority EU governments.** Italy, Spain, Austria, Sweden, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU, and they had threatened to derail the 7 year EU budget until a compromise was thrashed out in late 2020. There has also been a rise in anti-immigration sentiment in Germany and France.
- **Geopolitical risks,** for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.

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

- **UK -** a significant rise in inflationary pressures e.g. caused by a stronger than currently expected recovery in the UK economy after effective vaccines are administered quickly to the UK population, leading to a rapid resumption of normal life and return to full economic activity across all sectors of the economy.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a rapid series of increases in Bank Rate to stifle inflation.

APPENDIX G

Approved Countries For Investments (countries with a sovereign rating of AA- or higher) as at 20 January 2021

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link credit worthiness service.

AAA

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

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France

AA-

- Belgium
- Hong Kong
- Qatar
- **U.K.**

CAPITAL STRATEGY 2021/22

REPORT OF: HEAD OF CORPORATE RESOURCES
Contact Officer: Peter Stuart
Email: peter.stuart@midsussex.gov.uk Tel: 01444 477315
Wards Affected: All
Key Decision: No
Report to: Audit Committee
Date of Meeting: 2 March 2021

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1. Purpose of Report

1.1 To present the Capital Strategy for 2021/22 for approval by the Committee.

2 Recommendations

2.1 The Committee is recommended to forward the draft Strategy for approval by Council at the next appropriate meeting.

3. Background

3.1 Each year the Council is required to approve a corporate plan and budget that shows how it will deliver its services and spend its financial resources in the following financial year. This includes publishing a Capital Programme which sets out the level of investment in the Council's assets and the financing of that investment.

3.2 Our Corporate Plan has in the past included a Strategy designed to guide such investment but this good practice has now been formalised through a revision to the CIPFA Prudential Code. Authorities need therefore to present and have adopted a Capital Strategy each year.

3.3 Appendix 1 contains a draft Capital Strategy to fulfil the requirements of the Code. It sets out the principles by which we will make capital investment and aims to balance needs and expectations with available resources.

3.4 Members are invited to scrutinise the Strategy and satisfy themselves that it represents their collective view.

3.5 This policy would be formally adopted by Council

4. Policy Context

4.1 Adopting a Capital Strategy fulfils the Councils statutory duties:

5. Risk Management Implications

5.1 None. It is not considered that adopting this strategy brings forward any significant risk. All expenditure decisions are assessed individually.

6. Legal Implications

6.1 None.

7. Financial Implications

7.1 This report has no financial implications.

8. Equality and customer service implications

8.1 None.

9. Background Papers

9.1 None

Appendix 1

MID SUSSEX DISTRICT COUNCIL

CAPITAL STRATEGY 2021/22 to 2023/24

1. INTRODUCTION

1.1 Overview

This strategy forms the framework for capital investment decisions over the next three years and will inform the detailed annual capital budgets over this period. It is closely linked to the Treasury Management Strategy, the Investment Strategy and the Borrowing Strategy. The strategy aims to balance capital expenditure needs and expectations (e.g. replacement of business critical IT systems) with the scarcity of available resources.

1.2 Member approval and review

The Treasury Management Code allows authorities to delegate the detailed management of Treasury Management, including the Capital Strategy, to a sub-committee and this responsibility is delegated to the Audit Committee. This delegation will facilitate more active discussion of the Capital Strategy and its implementation, though overall responsibility will at all times remain with the full Council.

1.3 Strategic Direction of the Council

A key driver of the Capital Strategy is the Council's Statement of Main Purpose 'To be an effective Council delivering value for money services and helping to create a strong economy, environment and community' and the accompanying priorities:

- Efffective and responsive services
- Sustainable economic growth
- Strong and resilient communities
- Financial independence

This statement gives a strategic direction to the Council to enable it to meet the demands of the future.

1.4 Capital Expenditure

Capital expenditure, defined in accordance with the Council's approved accounting policies and procedures, can be funded in a variety of ways:

- Grants
- Section 106 contributions
- Capital receipts
- Direct Revenue contributions
- Borrowing

The method of funding for any particular scheme will depend on a number of factors and this is covered in more detail below. It should be noted that the Council

has limited resources for the funding of capital expenditure with balances having reduced significantly over recent years due to the use of reserves for property investment, earmarking for certain specific projects and financing the overall capital programme.

1.5 Whole life costing for capital schemes

Whole life costing can be defined as "the systematic consideration of all relevant costs and revenues associated with the acquisition and ownership of an asset." In practical terms this means that any appraisal of a proposed capital project will need to consider not just the initial capital cost but all costs and income streams associated with the project that are likely to occur in future years, including possible replacement or disposal costs. This is vital to ensure that the Council is not committing itself to future liabilities that are unsustainable.

1.6 Scheme Evaluation and Risk

Any appraisal of proposed new capital schemes should include a full evaluation of risk, having regard to the whole life costing methodology set out above.

1.7 Monitoring of approved capital schemes

For approved capital schemes it is the responsibility of the relevant budget holder to manage costs and to provide explanations for any variations from the approved budget, in accordance with Financial Procedure Rules. Budget monitoring statements are presented to Corporate Management Team and Cabinet on a roughly quarterly basis.

2. GENERAL FUND PROGRAMME

2.1 Core annual programme

The Council has a core annual programme comprising asset management (all owned or leased assets), Information Technology and Disabled Facilities Grants (DFGs). DFGs pay for essential adaptations to help people with disabilities stay in their own homes. The DFG programme is entirely funded by Government Grant whereas the asset management and Information technology programmes are funded by capital receipts where available or revenue contributions if not, or not appropriate to be capitalised.

2.2 Land and Property Revenue Reserve

A property investment fund has been established with the aim of acquiring properties to generate a return for the Council. Property acquisitions have been funded from earmarking a proportion of the Council's general reserve but in the future we will prioritise the use of receipts from land and property disposals. Acquisitions can only be made once a full business case has been completed and the risks fully understood and evaluated. This reserve is presently only minimally funded and no investments can therefore be made.

2.3 Other Schemes

In addition to the core annual programme other schemes will be considered subject to the criteria set out below. However, the key issue here is the modest funding, as reflected in the Council's medium term financial strategy which envisages only a modest programme. It is therefore particularly important that any new schemes have a clear benefit to ensure that limited resources are

used in the most effective possible way

2.4 Prioritising new schemes

In common with other local authorities Mid Sussex is facing a challenging financial climate and it is therefore essential that systems are in place to ensure that scarce resources are allocated in the most effective possible way. New schemes will be assessed against the following criteria:

- Link to the Council's strategic direction
- Availability of specific external funding
- Demonstration of a sound business case
- Whole life cost implications (see 1.5 above)
- Value for money

High priority will be given to the replacement of business-critical IT systems although these are increasingly being delivered as a SaaS (software as a service) model, requiring annual revenue only.

New schemes will have a Justification Statement that sets out the key factors considered prior to approval by Members.

2.5 Affordability and available resources

In addition to consider the merits of individual schemes the Council will need to assess the overall affordability of any new programme, having regard to the availability of resources, existing financial commitments and the projected level of balances forecast in the medium term financial strategy. As outlined in 1.4 above, possible sources of funding for capital schemes are:

- Grants
- Section 106 contributions
- Capital receipts
- Direct Revenue contributions
- Borrowing

2.6 Specific resource issues

Grants and Section 106 contributions are generally used to fund specific capital schemes linked to the conditions imposed by the relevant grant or section 106 contribution. There is little, if any, latitude in the way this funding can be applied. Capital receipts are derived from the sale of the Council's assets. It is the Council's policy to use these receipts to support the General Fund capital programme. A proportion of these receipts may be earmarked for the purchase of land and property (see 2.2 above). Revenue contributions are a flexible source of funding but they put an immediate strain on the General Fund balance and can therefore only be used to a limited extent. Borrowing spreads the cost over a number of years but loan servicing costs and the overall level of debt exposure both need to be considered and clearly flagged in a business case.

2.7 Major schemes already approved and committed

The existing capital programme includes a number of schemes which the Council is fully committed to delivering, although these are not individually significant. It is however likely that until capital receipts become available, the scale of approval for new schemes will be limited.

3. LINKS TO OTHER COUNCIL STRATEGIES

3.1 Treasury Management Strategy

The Capital Strategy is closely linked to the Treasury Management Strategy and it is essential that any investment decisions are informed by both strategies. In particular the assessment of affordability outlined in 2.5 above will need to have regard to the relevant elements of the Treasury Management Strategy including:

- The incremental impact of capital investment on council tax levels
- The borrowing strategy
- The authorised limit for external debt

3.2 Property Investment Strategy

This Strategy will set out the policies relating to the Land and Property Reserve (see above). The landscape for commercial property investment has changed with the recent new guidance on borrowing from the PWLB; this needs assimilating and working up into any new policy. In the meantime, individual transactions would need concurrent agreement by a variety of key Members, i.e. appropriate Cabinet Portfolio Holders and the Chairs of the Scrutiny Committee for Leader, Finance and Performance and the Audit Committee.

3.3 Asset Management Strategy

As outlined in 2.1 above, there is a core annual programme to cover capitalised repairs and improvements for all the Council's assets. The asset management strategy establishes the priorities for this programme having regard to the condition of the various assets and their respective priorities in terms of delivering Council services or generating rental income.

Proposed New Projects - Capital Programme and Revenue Projects 2021/22 - 2024/25

	Project Justification	Total 2021/22	Total 2022/23	Total 2023/24	Total 2024/25	Revenue Implications
Capital Projects		**£'000s**	**£'000s**	**£'000s**	**£'000s**	**£'000s**
ICT Projects						
Workstation Replacement - Phase III	Yes	50	50	50	50	
Oaklands Wifi Refit	Yes	50				
Total ICT Projects funded from Capital Receipts:		**100**	**50**	**50**	**50**	**0**
Others:						
Garden Waste Bins	Yes	30				30 *
Total Others:		**30**	**0**	**0**	**0**	**30**
Major Capital Renewals						
Oaklands:						
Oaklands Window Replacement Phase IV	Yes	145				
Partial Resurfacing of Oaklands Car Park	Yes	34				
Heating works Phase 3	Yes	106				
Unallocated funding for future years	n/a		162	130	146	
Total Major Capital Renewals	n/a	**285**	**162**	**130**	**146**	**0**
Housing						
Temporary Accommodation	Yes	2,800				
Affordable Housing	n/a	1,000	846			
Total Housing		**3,800**	**846**	**0**	**0**	**0**
Environmental Health						
Disabled Facility Grants	n/a	900	900	900	900	
Total Environmental Health		**900**	**900**	**900**	**900**	**0**
Total New Capital Projects		**5,115**	**1,958**	**1,080**	**1,096**	**30**
Financed By:						
Grant Contributions WSCC		900	900	900	900	
S106 Housing - non time limited		1,000	371	0	0	
S106 Housing - time limited			475	0	0	
Met from Revenue Contributions (for MCR)		285	162	130	146	
Capital Receipts		2,930	50	50	50	
Total Financed:		**5,115**	**1,958**	**1,080**	**1,096**	**0**

* PYE in 21/22. Additional income of £47k from 2022/23 onwards

Revenue Projects		**£'000s**	**£'000s**	**£'000s**	**£'000s**	**£'000s**
ICT Projects						
Network Infrastructure Maintenance Project	Yes	20				
Total ICT Projects funded from General Reserve:		**20**	**0**	**0**	**0**	**0**
Total New Revenue Projects		**20**	**0**	**0**	**0**	**0**
Financed By:						
General Reserve		20	0	0	0	
Total Financed:		**20**	**0**	**0**	**0**	**0**

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