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Tandridge District Council

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To: MEMBERS OF THE INVESTMENT SUB COMMITTEE
Councillors Bourne (Chair), Cooper, Elias, Jones and Langton

Substitute Councillors: Bloore, Caulcott and Farr

C.C. All Other Members of the Council

for any enquiries, please contact:
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01883 722000

17 January 2022

Dear Sir/Madam

INVESTMENT SUB COMMITTEE
FRIDAY, 21ST JANUARY, 2022 AT 10.00 AM

The agenda for this meeting of the Sub-Committee to be held in the Council Chamber, Council Offices, Station Road East, Oxted is set out below. If a member of the Sub-Committee is unable to attend the meeting, please notify officers accordingly.

Should members require clarification about any item of business, they are urged to contact officers before the meeting. In this respect, reports contain authors' names and contact details.

If a Member of the Council, not being a member of the Sub-Committee, proposes to attend the meeting, please let the officers know by no later than noon on the day of the meeting.

Yours faithfully,

David Ford
Chief Executive

AGENDA

1. Apologies for absence (if any)

2. Declarations of interest

All Members present are required to declare, at this point in the meeting or as soon as possible thereafter:

(i) any Disclosable Pecuniary Interests (DPIs) and / or
(ii) other interests arising under the Code of Conduct

in respect of any item(s) of business being considered at the meeting. Anyone with a DPI must, unless a dispensation has been granted, withdraw from the meeting during consideration of the relevant item of business. If in doubt, advice should be sought from the Monitoring Officer or her staff prior to the meeting.

3. Minutes of the meeting held on the 5th November 2021 (Pages 3 - 10)
To confirm as a correct record

4. Summary Investment and Borrowing Position at 31 December 2021 (Pages 11 - 18)

5. **Fund Manager Selection** (Pages 19 - 46)

6. **Capital, Investment and Treasury Management Strategy** (Pages 47 - 108)

7. **Any other business which, in the opinion of the Chair, should be considered as a matter of urgency**

8. **To consider passing the following resolution to exclude the press and public:**

R E S O L V E D – that members of the press and public be excluded from the meeting for agenda item 9 under Section 100A (4) of the Local Government Act 1972 (as amended) on the grounds that:

(i) it involves the likely disclosure of exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A of the Act; and

(ii) for the item the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

9. **Property investment update (verbal update to be given at the meeting)**

TANDRIDGE DISTRICT COUNCIL

INVESTMENT SUB COMMITTEE

Minutes and report to Council of the meeting of the Sub-Committee held in the Council Chamber, Council Offices, Station Road East, Oxted on the 5 November 2021 at 10.00am.

PRESENT: Councillors Bourne (Chair), Cooper, Elias and Langton

ALSO PRESENT: Councillors Farr

APOLOGIES FOR ABSENCE: Councillor Jones

1. MINUTES OF THE MEETING HELD ON THE 24TH SEPTEMBER 2021

The minutes were confirmed and signed as a correct record.

2. SUMMARY INVESTMENT AND BORROWING POSITION AT 30TH SEPTEMBER 2021

The investment analysis at Appendices A and B was presented.

The Chair explained that the anticipated remodelled report from Link Group (the Council's treasury advisors) would now be presented to the Sub-Committee's meeting on the 21st January 2022. This would help to inform a decision on the use of the redeemed proceeds from Funding Circle which had accumulated since the decision to cease re-investing in its peer to peer loans and to withdraw funds as those loans were repaid. It was confirmed that the 11.2% yield rate from Funding Circle (Appendix A refers) reflected the withdrawal of the principal element of the investment, together with a one-off recovery of non-performing loans amounting to £38,000 and did not reflect pure income.

Members reiterated their wish from the 11th June 2021 meeting that the term 'high yielding' should be removed from future investment reports.

> ***R E S O L V E D*** – that the Council's investment and borrowing position at 30th September 2021, as set out in Appendices A and B, be noted.

3. GRYLLUS HOLDINGS, GRYLLUS HOUSING AND GRYLLUS PROPERTY FINAL ACCOUNTS 2020/21

The Sub-Committee considered financial statements for the year ended 31st March 2021 in respect of these Council owned subsidiary companies, together with a report from Kreston Reeves LLP arising from its audit of the accounts.

The key issues identified within the Officer covering report were:

- Gryllus Holdings had been dormant during the reporting period and an unqualified audit opinion had been issued. (The term 'dormant' was questioned during the debate, but it was acknowledged that the company had not been trading and that no movement of balances had taken place).

- Gryllus Housing had been dormant during the reporting period and the accounts were unaudited.

- Gryllus Property Limited had recorded a loss of £1,792,530 arising from revaluations of the company's three properties (30-32 Week Street, Maidstone; 80-84 Station Road East, Oxted and Castlefield House, Reigate). This had been expected as Castlefield House was purchased during the 2020/21 reporting year and its valuation had attracted one off purchase costs. Without such costs, the company made an operational post tax profit of £72,373. An unqualified audit opinion had been issued.

The Kreston Reeves audit had identified:

- a late VAT payment (by one day) which had incurred an HMRC penalty fine
- an incorrect posting of £205,583 rental income.

Consequently, Kreston Reeves had recommended measures to reduce the likelihood of such errors reoccurring, namely additional staffing capacity to deal with VAT payments and a quarterly reconciliation of actual and expected rental income. It was confirmed that these matters would be addressed as part of the Finance Transformation Programme.

The Chief Finance Officer (Anna D'Alessandro) advised that she had replaced Simon Jones as a director of all three companies.

R E S O L V E D – that the following be noted:

(i) the annual financial statements for Gryllus Holdings Limited, Gryllus Housing Limited and Gryllus Property Limited for the year ended 31st March 2021;

(ii) the report from Kreston Reeves arising from its annual audit of Gryllus Holdings Limited and Gryllus Property Limited for the year ended 31st March 2021; and

(iii) the management accounts for Gryllus Property Limited (profit by property).

4. INVESTMENT PROPERTY UPDATE

The Sub-Committee resolved to move into ‘Part 2’ for this item in accordance with Paragraph 3 (information relating to financial or business affairs) of Part 1 of Schedule 12A of the Local Government Act 1972.

The officer report advised Members about the performance of the of the commercial investment properties owned by the Council and its subsidiary company, Gryllus properties:

TDC properties:

- Quadrant House, Caterham Valley
- Redstone House, South Nutfield
- Village Health Club, Caterham on the Hill

Gryllus properties:

- Castlefield House, Reigate
- 80-84 Station Road East, Oxted
- 30-32 Week Street, Maidstone

The information comprised an update about asset management activity for each property; an analysis of opportunities and risks; and valuations carried out by Wilkes, Head and Eve (WHE) in December 2020 for the Gryllus properties and February 2021 for the TDC properties. Members considered that future WHE valuations would benefit from input from the asset management team to ensure they were as realistic as possible.

Members were also provided with:

- rent / service charge collection data for Quadrant House and a risk register compiled by Huntley Cartwright quantity surveyors; and

- an options analysis from Colliers (property consultants) regarding the future use of 30-32 Week Street. Arising from this, it was acknowledged that the property would be marketed ‘to let’.

The officer report advocated that Redstone House be sold. Under the Council’s scheme of delegation (Part E of the Constitution) such a disposal, due its value being more than £1 million, would need to be recommended by the Strategy & Resources Committee for ratification by Full Council. The property had recently been vacated by the Surrey & Borders Partnership NHS Foundation Trust which had been paying rent of approximately £50,000 per annum to the Housing General Fund. The rationale for selling the property had been presented in a briefing note to the Sub-Committee, Bletchingley & Nutfield Ward Councillors and Housing Committee members. The briefing note was appended to the agenda pack for the meeting and explained why the property was considered inappropriate for use as social housing.

The Sub-Committee supported the recommendation to sell Redstone House but considered that planning permission should be sought by the Council with a view to the property being offered for sale with the required consents in place.

Members also requested additional information regarding the capital expenditure requirements for Linden House prior to its re-letting. Officers undertook to provide this after the meeting.

R E S O L V E D – that

A. the recent and proposed property asset management activity be noted; and

B. Redstone House be marketed for sale and that planning consent for the necessary changes of use be sought to enable the property to be sold with the required planning permission already in place.

COUNCIL DECISION
(subject to ratification by the
Strategy & Resources Committee and Full Council)

R E C O M M E N D E D – that Redstone House be sold for the best consideration as can be achieved by the Executive Head of Communities.

A C T I O N S:

		Officers responsible for ensuring completion	**Deadline**
1	Future external property valuations be informed by contributions from the Council's asset management team	Claire Hinds (Finance Business Partner) to liaise with Kate Haacke (Lead Asset Management Specialist)	As soon as practicable prior to the next valuation
2	E-mail to Sub-Committee members confirming the capital expenditure requirements for Linden House prior to its re-letting	Kate Haacke (Lead Asset Management Specialist)	19.11.21

Rising 11.24 am

Summary of Investments and Borrowing **Appendix A**

Investment	Investment Amount 31/03/21 £	Net Asset Value 30/09/21 £	Yield Rate Note 1 %	Forecast Return 2021/22 £	Previous Year Actual £
Non - Specified (Financial Investments)- Long Term (over 12 mths)					
CCLA Property Fund	4,000,000	4,448,206	3.65	162,300	179,910
Schroders Bond Fund	3,000,000	2,915,856	4.38	127,600	125,529
UBS Multi Asset Fund	3,000,000	2,794,549	4.34	121,300	140,171
CCLA Diversification Fund	2,000,000	2,051,402	3.23	66,200	62,069
Funding Circle	863,160	637,686	11.20	84,900	77,070
Sub Total Non-specified (Financial Investments)	**12,863,160**	**12,847,699**		**562,300**	**584,749**
Non - Specified (Non-Financial Investments)- Long Term (over 12 mths)					
Gryllus Property Company Loan - Maidstone	2,394,000	2,394,000	5.81	139,023	139,023
Freedom Leisure- Loan (TLP)	774,857	774,857	5.50	42,600	53,271
Freedom Leisure- Loan (de Stafford)	496,571	496,571	7.58	37,600	47,050
Gryllus Property Company Loan - 80-84 Station Rd East	1,012,500	1,012,500	5.81	54,979	54,979
Gryllus Property Company Loan - Castlefield	11,664,000	11,664,000	6.10	711,504	711,504
Gryllus Property Company Share Capital Note 2	5,251,500	5,251,500	-	-	0
Sub Total Non-specified (Non-Financial Investments)	**21,593,429**	**21,593,429**		**985,706**	**1,005,827**
Total Non-Specified Investments	**34,456,589**	**34,441,128**		**1,548,006**	**1,590,576**
Specified Investments-Short Term (less than 12 mths)					
Notice Accounts	4,000,000	4,042,002	0.17	7,000	11,449
Money Market Funds	3,250,000	12,285,000	0.02	2,700	15,870
Total Specified Investments	**7,250,000**	**16,327,002**		**9,700**	**27,319**
Total Non- Specified and Specified Investments	**41,706,589**	**50,768,130**		**1,557,706**	**1,617,895**
Total Investment Income Budget 2021/22				1,515,700	2,764,200
Over/(under) budget				**42,006**	**(1,146,305)**

Borrowing	Loan Amount £	Interest %	Forecast Cost 2021/22 £	Previous Year Cost £
General Fund Borrowing				
Gryllus Loan	3,420,000	2.46	84,132	84,132
Freedom Leisure Loan	2,225,000	2.45	54,513	54,513
Village Health Club	938,678	2.38	22,341	22,341
Linden House	4,175,000	2.69	112,308	112,308
Linden House	254,000	2.42	6,147	6,147
Quadrant House	15,340,000	2.41	369,694	369,694
Quadrant House	800,000	2.28	18,240	18,240
Gryllus - 80-84 Station Road	724,400	2.28	16,516	16,516
Gryllus - Castlefield	15,549,000	2.91	452,476	450,913
Sub Total General Fund Borrowing	**43,426,078**		**1,136,366**	**1,134,803**
Total GF PWLB Budget 2021/22			**1,137,000**	**1,889,000**
Over/(under) budget			**(634)**	**(754,197)**
HRA Borrowing				
Public Works Loan Board	61,189,000	2.70	1,632,209	1,661,341
Sub Total HRA Borrowing	**61,189,000**		**1,632,209**	**1,661,341**
Total HRA PWLB Budget 2021/22			**1,662,500**	**1,926,500**
Over/(under) budget			**(30,291)**	**(265,159)**
Total Borrowing	**104,615,078**		**2,768,575**	**2,796,144**
Total Budget 2021/22			**2,799,500**	**3,815,500**
Total Over/(under) budget			**(30,925)**	**(1,019,356)**

Notes:

1. Yield Rate - forecast annual return divided by net asset value. Funding Circle yield rate - forecast annual return divided by average opening & closing net asset value adjusted for estimated principal withdrawn Sept 21 to Mar 22
2. Gryllus share capital comprises of equity shares arising from loans granted - no dividend will be paid in the current year

Market Value of Long Term Investments at 30/09/2021

Appendix B

Carrying Value	2016/17 Carrying Value 31.3.2017	2017/18 Carrying Value 31.3.2018	2018/19 Carrying Value 31.3.2019	2019/20 Carrying Value 31.03.2020	2020/21 Carrying Value 31.03.2021	2021/22 Carrying Value 30.09.2021
	£	£	£	£	£	£
CCLA Property Fund	4,000,000	4,000,000	4,000,000	4,000,000	4,000,000	4,000,000
Schroders Bond Fund	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000
UBS Multi Asset Fund	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000
CCLA Diversification Fund	n/a	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Total	**10,000,000**	**12,000,000**	**12,000,000**	**12,000,000**	**12,000,000**	**12,000,000**

Market Value	2016/17 Market Value 31.3.2017	2017/18 Market Value 31.3.2018	2018/19 Market Value 31.3.2019	2019/20 Market Value 31.03.2020	2020/21 Market Value 31.03.2021	2020/21 Market Value 30.09.2021
	£	£	£	£	£	£
CCLA Property Fund(mid-market value)	4,082,986	4,276,854	4,276,005	4,188,063	4,158,183	4,448,206
Schroders Bond Fund	2,963,563	2,912,837	2,865,130	2,539,938	2,908,911	2,915,856
UBS Multi Asset Fund	3,018,705	2,918,160	2,868,479	2,520,713	2,777,398	2,794,549
CCLA Diversification Fund(indicative market value)	n/a	1,921,257	1,982,167	1,804,193	1,955,874	2,051,402
Total	**10,065,254**	**12,029,108**	**11,991,781**	**11,052,907**	**11,800,366**	**12,210,013**

Surplus/(Deficit)	2016/17 Surplus/ (Deficit) 31.3.2017	2017/18 Surplus/ (Deficit) 31.3.2018	2018/19 Surplus/ (Deficit) 31.3.2019	2019/20 Surplus/ (Deficit) 31.03.2020	2020/21 Surplus/ (Deficit) 31.03.2021	2020/21 Surplus/ (Deficit) 30.09.2021
	£	£	£	£		
CCLA Property Fund	82,986	276,854	276,005	188,063	158,183	448,206
Schroders Bond Fund	(36,437)	(87,163)	(134,870)	(460,062)	(91,089)	(84,144)
UBS Multi Asset Fund	18,705	(81,840)	(131,521)	(479,287)	(222,602)	(205,451)
CCLA Diversification Fund	n/a	(78,743)	(17,833)	(195,807)	(44,126)	51,402
Total	**65,254**	**29,108**	**(8,219)**	**(947,093)**	**(199,634)**	**210,013**

Gross Revenue Yield	Yield 2016/17	Yield 2016/17	Yield 2017/18	Yield 2017/18	Yield 2018/19	Yield 2018/19	Yield 2019/20	Yield 2019/20	Yield 2020/21	Yield 2020/21
	£	%	£	%	£	%	£	%	£	%
CCLA Property Fund	164,434	4.03%	193,758	4.53%	183,989	4.30%	185,240	4.42%	179,910	4.33%
Schroders Bond Fund	127,340	4.30%	105,413	3.62%	120,508	4.21%	124,418	4.90%	125,529	4.32%
UBS Multi Asset Fund	100,600	3.33%	146,788	5.03%	116,513	4.06%	137,531	5.46%	140,171	5.05%
CCLA Diversification Fund	n/a	n/a	62,732	3.27%	67,030	3.38%	66,284	3.67%	62,069	3.17%
Total	**392,375**		**508,691**		**488,040**		**513,473**		**507,679**	

Surplus/(Deficit)- Capital Value	Surplus/ (Deficit) 2016/17	Surplus/ (Deficit) 2016/17	Surplus/ (Deficit) 2017/18	Surplus/ (Deficit) 2017/18	Surplus/ (Deficit) 2018/19	Surplus/ (Deficit) 2018/19	Surplus/ (Deficit) 2019/20	Surplus/ (Deficit) 2019/20	Surplus/ (Deficit) 2020/21	Surplus/ (Deficit) 2020/21
	£	%	£	%	£	%	£	%	£	%
CCLA Property Fund	(92,996)	-2.28%	193,868	4.53%	(849)	-0.02%	(87,942)	-2.10%	(29,880)	-0.72%
Schroders Bond Fund	16,634	0.56%	(50,726)	-1.74%	(47,707)	-1.67%	(325,192)	-12.80%	368,973	12.68%
UBS Multi Asset Fund	36,559	1.21%	(100,545)	-3.45%	(49,681)	-1.73%	(347,766)	-13.80%	256,685	9.24%
CCLA Diversification Fund	n/a	n/a	(78,743)	-4.10%	60,910	3.07%	(177,974)	-9.86%	151,682	7.76%
Total	**(39,803)**		**(36,146)**		**(37,327)**		**(938,874)**		**747,460**	

Net Yield	Net Yield 2016/17	Net Yield 2016/17	Net Yield 2017/18	Net Yield 2017/18	Net Yield 2018/19	Net Yield 2018/19	Net Yield 2019/20	Net Yield 2019/20	Net Yield 2020/21	Net Yield 2020/21
	£	%	£	%	£	%	£	%	£	%
CCLA Property Fund	71,438	1.75%	387,626	9.06%	183,140	4.28%	97,298	2.32%	150,030	3.61%
Schroders Bond Fund	143,974	4.86%	54,687	1.88%	72,801	2.54%	(200,774)	-7.90%	494,503	17.00%
UBS Multi Asset Fund	137,159	4.54%	46,243	1.58%	66,832	2.33%	(210,235)	-8.34%	396,856	14.29%
CCLA Diversification Fund	n/a	n/a	(16,011)	-0.83%	127,940	6.45%	(111,690)	-6.19%	213,751	10.93%
Total	**352,572**		**472,545**		**450,713**		**(425,401)**		**1,255,139**	

Peer to Peer Investment	2016/17	2016/17	2017/18	2017/18	2018/19	2018/19	2019/20	2019/20	2020/21	2020/21
Funding Circle	£	%	£	%	£	%	£	%	£	%
Carrying Value	**2,003,355**		**2,075,341**		**2,056,664**		**1,831,028**		**863,160**	
Interest Paid by Borrowers	181,892		181,014		184,654		193,170		127,982	
Less FC Service fee	(19,121)		(19,668)		(19,729)		(19,611)		(12,462)	
Promotions/Transfer payment							470		0	
Bad Debts	(58,163)		(61,288)		(111,152)		(127,649)		(80,881)	
Recoveries	8,219		14,780		27,428		30,253		42,431	
Net Yield	**112,827**	**5.63%**	**114,838**	**5.53%**	**81,201**	**3.95%**	**76,634**	**4.19%**	**77,070**	**8.93%** *
Provisions for future losses	**0**		**0**		**(10,000)**					

*Funding Circle Net yield - this has been calculated against the current value, however principal has been withdrawn throughout the year. If calculated against the average of the opening and closing value then the net yield w
there was a large recovery received in June 2021 (£38,494) which has inflated this yield.

Summary Investment and Borrowing Position at 31 December 2021

Investment Sub Committee Friday, 21 January 2022

Report of: Chief Finance Officer (Section 151)

Purpose: For information

Publication status: Unrestricted

Wards affected: All

Executive summary:

This report updates the Investment Sub Committee on the Council's investment and borrowing position at 31st December 2021.

This report supports the Council's priority of: Building a better Council/ Supporting economic recovery in Tandridge.

Contact officer Claire Hinds

chinds@tandridge.gov.uk

Recommendation to the Sub-Committee:

That the Sub Committee notes the Council's Investment and Borrowing position at 31st December 2021 as set out on Appendix 'A' & 'B'.

Reason for recommendation:

This report will be reviewed by the Sub Committee, which provides an update on the Council's investment and borrowing position.

1. Introduction and background

1.1 The Capital, Investment and Treasury Management Strategy 2021/22 was reported to the Strategy and Resources Committee on 2nd February 2021. This covered the borrowing and investment plans for the Council. As detailed in this strategy, part of the treasury management function is to ensure that the cashflow is adequately planned and surpluses are invested while allowing for cash to be available when needed. Additionally, the treasury management function ensures that the Council can meet its capital spending plans. This requires the management of longer term cash which will involve the use of long or short-term loans, or cash flow surpluses.

2. Summary Investment and Borrowing Position

2.1 A summary of the Council's investment and borrowing at 31st December 2021 is set out in Appendix A.

- Total long term financial investments (over 12 months) amount to £12.9 million.
- Short term investments (less than 12 months) amount to £20.0 million.
- The Council also has £21.4 million in non-financial investments which is made up of capital loans to specific service providers and limited companies.
- The total amount of Public Works Loan Board (PWLB) loans at 31st December 2021 £104.6 million. This is made up of £43.4 million General Fund loans and £61.2 million Housing Revenue Account loans.

2.2 Appendix A shows the investments as short term and long term. The categorisation of this differs from how they are represented in the Statement of Accounts. A review of the differences in categorisation will be done as part of the closing process for 2021/22.

3. Funding Circle/Fund Manager Selection

3.1 A Fund Manager report is being presented to this committee as agreed at the Investment Sub Committee 24th September 2021 in respect of the work done by our treasury advisers, Link Group, and therefore does not form part of this summary investment and borrowing position.

Key implications

4. Comments of the Chief Finance Officer

4.1 The current forecast is that the investment income will be c£38,000 more than budgeted. This is mainly due to a one-off receipt from Funding Circle in June for sale of non-performing loans previously charged as bad debt against net earnings.

4.2 With all investments there are increased risks. The Council manages these risks by continued diversification of its investments.

5. Comments of the Head of Legal Services

5.1 The Council's Treasury Management Strategy Statement follows the latest codes of practice and the MHCLG and CIPFA guidance.

5.2 The Council has borrowed and invested sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

5.3 In order to ensure that the Council's financial risk is mitigated as far as possible an experienced and qualified FCA regulated fund manager should be procured at the earliest.

6. Equality

6.1 The proposals within this report do not have the potential to disadvantage or discriminate against different groups with protected characteristics in the community.

7. Climate change

7.1 There are no significant environmental/sustainability implications associated with the report. It is however recognised that some Council investments may be in companies that are considered to have a detrimental impact on the climate, for example oil companies.

Appendices

Appendix 'A' – Summary of Investments and Borrowing

Appendix 'B' – Market Value of Long Term Investments

Background papers

None

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Summary of Investments and Borrowing **Appendix A**

Investment	Investment Amount 31/03/21 £	Net Asset Value 31/12/21 £	Yield Rate Note 1 %	Forecast Return 2021/22 £
Non - Specified (Financial Investments)- Long Term (over 12 mths)				
CCLA Property Fund	4,000,000	4,672,521	3.37	157,400
Schroders Bond Fund	3,000,000	2,915,856	4.38	127,600
UBS Multi Asset Fund	3,000,000	2,772,075	4.79	132,800
CCLA Diversification Fund	2,000,000	2,110,463	2.59	54,600
Funding Circle	863,160	469,576	-	85,100
Sub Total Non-specified (Financial Investments)	**12,863,160**	**12,940,491**		**557,500**
Non - Specified (Non-Financial Investments)- Long Term (over 12 mths)				
Gryllus Property Company Loan - Maidstone	2,394,000	2,394,000	5.81	139,023
Freedom Leisure- Loan (TLP)	774,857	678,001	5.50	42,600
Freedom Leisure- Loan (de Stafford)	496,571	434,501	7.58	37,600
Gryllus Property Company Loan - 80-84 Station Rd East	1,012,500	1,012,500	5.43	54,979
Gryllus Property Company Loan - Castlefield	11,664,000	11,664,000	6.10	711,504
Gryllus Property Company Share Capital Note 2	5,251,500	5,251,500	-	-
Sub Total Non-specified (Non-Financial Investments)	**21,593,429**	**21,434,503**		**985,706**
Total Non-Specified Investments	**34,456,589**	**34,374,994**		**1,543,206**
Specified Investments-Short Term (less than 12 mths)				
Notice Accounts	4,000,000	4,040,726	0.17	7,000
Money Market Funds	3,250,000	16,005,000	0.05	3,000
Total Specified Investments	**7,250,000**	**20,045,726**		**10,000**
Total Non- Specified and Specified Investments	**41,706,589**	**54,420,720**		**1,553,206**
Total Investment Income Budget 2021/22				1,515,700
Over/(under) budget				**37,506**

Borrowing	Loan Amount £	Interest %	Forecast Cost 2021/22 £
General Fund Borrowing			
Gryllus Loan	3,420,000	2.46	84,132
Freedom Leisure Loan	2,225,000	2.45	54,513
Village Health Club	938,678	2.38	22,341
Linden House	4,175,000	2.69	112,308
Linden House	254,000	2.42	6,147
Quadrant House	15,340,000	2.41	369,694
Quadrant House	800,000	2.28	18,240
Gryllus - 80-84 Station Road	724,400	2.28	16,516
Gryllus - Castlefield	15,549,000	2.91	452,476
Sub Total General Fund Borrowing	**43,426,078**		**1,136,366**
Total GF PWLB Budget 2021/22			**1,137,000**
Over/(under) budget			**(634)**
HRA Borrowing			
Public Works Loan Board	61,189,000	2.70	1,632,209
Sub Total HRA Borrowing	**61,189,000**		**1,632,209**
Total HRA PWLB Budget 2021/22			**1,662,500**
Over/(under) budget			**(30,291)**
Total Borrowing	**104,615,078**		**2,768,575**
Total Budget 2021/22			**2,799,500**
Total Over/(under) budget			**(30,925)**

Notes:

1. Yield Rate - forecast return divided by net asset value.
2. Gryllus share capital comprises of equity shares arising from loans granted - no dividend will be paid in the current year

Market Value of Long Term Investments at 31/12/2021

Appendix B

Carrying Value	2016/17 Carrying Value 31.3.2017	2017/18 Carrying Value 31.3.2018	2018/19 Carrying Value 31.3.2019	2019/20 Carrying Value 31.03.2020	2020/21 Carrying Value 31.03.2021	2021/22 Carrying Value 31.12.2021
	£	£	£	£	£	£
CCLA Property Fund	4,000,000	4,000,000	4,000,000	4,000,000	4,000,000	4,000,000
Schroders Bond Fund	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000
UBS Multi Asset Fund	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000	3,000,000
CCLA Diversification Fund	n/a	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Total	**10,000,000**	**12,000,000**	**12,000,000**	**12,000,000**	**12,000,000**	**12,000,000**

Market Value	2016/17 Market Value 31.3.2017	2017/18 Market Value 31.3.2018	2018/19 Market Value 31.3.2019	2019/20 Market Value 31.03.2020	2020/21 Market Value 31.03.2021	2020/21 Market Value 31.12.2021
	£	£	£	£	£	£
CCLA Property Fund(mid-market value)	4,082,986	4,276,854	4,276,005	4,188,063	4,158,183	4,672,521
Schroders Bond Fund	2,963,563	2,912,837	2,865,130	2,539,938	2,908,911	2,915,856
UBS Multi Asset Fund	3,018,705	2,918,160	2,868,479	2,520,713	2,777,398	2,772,075
CCLA Diversification Fund(indicative market value)	n/a	1,921,257	1,982,167	1,804,193	1,955,874	2,110,463
Total	**10,065,254**	**12,029,108**	**11,991,781**	**11,052,907**	**11,800,366**	**12,470,915**

Surplus/(Deficit)	2016/17 Surplus/ (Deficit) 31.3.2017	2017/18 Surplus/ (Deficit) 31.3.2018	2018/19 Surplus/ (Deficit) 31.3.2019	2019/20 Surplus/ (Deficit) 31.03.2020	2020/21 Surplus/ (Deficit) 31.03.2021	2020/21 Surplus/ (Deficit) 31.12.2021
	£	£	£	£		
CCLA Property Fund	82,986	276,854	276,005	188,063	158,183	672,521
Schroders Bond Fund	(36,437)	(87,163)	(134,870)	(460,062)	(91,089)	(84,144)
UBS Multi Asset Fund	18,705	(81,840)	(131,521)	(479,287)	(222,602)	(227,925)
CCLA Diversification Fund	n/a	(78,743)	(17,833)	(195,807)	(44,126)	110,463
Total	**65,254**	**29,108**	**(8,219)**	**(947,093)**	**(199,634)**	**470,915**

Gross Revenue Yield	Yield 2016/17	Yield 2016/17	Yield 2017/18	Yield 2017/18	Yield 2018/19	Yield 2018/19	Yield 2019/20	Yield 2019/20	Yield 2020/21	Yield 2020/21	Full Year forecast at 31.12.21 Yield 2021/22	Full Year forecast at 31.12.21 Yield 2021/22
	£	%	£	%	£	%	£	%	£	%	£	%
CCLA Property Fund	164,434	4.03%	193,758	4.53%	183,989	4.30%	185,240	4.42%	179,910	4.33%	157,400	3.37%
Schroders Bond Fund	127,340	4.30%	105,413	3.62%	120,508	4.21%	124,418	4.90%	125,529	4.32%	127,600	4.38%
UBS Multi Asset Fund	100,600	3.33%	146,788	5.03%	116,513	4.06%	137,531	5.46%	140,171	5.05%	132,800	4.79%
CCLA Diversification Fund	n/a	n/a	62,732	3.27%	67,030	3.38%	66,284	3.67%	62,069	3.17%	54,600	2.59%
Total	**392,375**		**508,691**		**488,040**		**513,473**		**507,679**		**472,400**	

Surplus/(Deficit)- Capital Value	Surplus/ (Deficit) 2016/17	Surplus/ (Deficit) 2016/17	Surplus/ (Deficit) 2017/18	Surplus/ (Deficit) 2017/18	Surplus/ (Deficit) 2018/19	Surplus/ (Deficit) 2018/19	Surplus/ (Deficit) 2019/20	Surplus/ (Deficit) 2019/20	Surplus/ (Deficit) 2020/21	Surplus/ (Deficit) 2020/21	Full Year forecast at 31.12.21 Surplus/ (Deficit) 2021/22	Full Year forecast at 31.12.21 Surplus/ (Deficit) 2021/22
	£	%	£	%	£	%	£	%	£	%	£	%
CCLA Property Fund	(92,996)	-2.28%	193,868	4.53%	(849)	-0.02%	(87,942)	-2.10%	(29,880)	-0.72%	514,338	11.01%
Schroders Bond Fund	16,634	0.56%	(50,726)	-1.74%	(47,707)	-1.67%	(325,192)	-12.80%	368,973	12.68%	6,945	0.24%
UBS Multi Asset Fund	36,559	1.21%	(100,545)	-3.45%	(49,681)	-1.73%	(347,766)	-13.80%	256,685	9.24%	(5,323)	-0.19%
CCLA Diversification Fund	n/a	n/a	(78,743)	-4.10%	60,910	3.07%	(177,974)	-9.86%	151,682	7.76%	154,588	7.32%
Total	**(39,803)**		**(36,146)**		**(37,327)**		**(938,874)**		**747,460**		**670,548**	

Net Yield	Net Yield 2016/17	Net Yield 2016/17	Net Yield 2017/18	Net Yield 2017/18	Net Yield 2018/19	Net Yield 2018/19	Net Yield 2019/20	Net Yield 2019/20	Net Yield 2020/21	Net Yield 2020/21	Full Year forecast at 31.12.21 Net Yield 2021/22	Full Year forecast at 31.12.21 Net Yield 2021/22
	£	%	£	%	£	%	£	%	£	%	£	%
CCLA Property Fund	71,438	1.75%	387,626	9.06%	183,140	4.28%	97,298	2.32%	150,030	3.61%	671,738	14.38%
Schroders Bond Fund	143,974	4.86%	54,687	1.88%	72,801	2.54%	(200,774)	-7.90%	494,503	17.00%	134,545	4.61%
UBS Multi Asset Fund	137,159	4.54%	46,243	1.58%	66,832	2.33%	(210,235)	-8.34%	396,856	14.29%	127,477	4.60%
CCLA Diversification Fund	n/a	n/a	(16,011)	-0.83%	127,940	6.45%	(111,690)	-6.19%	213,751	10.93%	209,188	9.91%
Total	**352,572**		**472,545**		**450,713**		**(425,401)**		**1,255,139**		**1,142,948**	

Peer to Peer Investment	2016/17	2016/17	2017/18	2017/18	2018/19	2018/19	2019/20	2019/20	2020/21	2020/21	31.11.21 2020/21	31.11.21 2020/21
Funding Circle	£	%	£	%	£	%	£	%	£	%	£	%
Carrying Value	**2,003,355**		**2,075,341**		**2,056,664**		**1,831,028**		**863,160**		**409,576**	
Interest Paid by Borrowers	181,892		181,014		184,654		193,170		127,982		54,852	
Less FC Service fee	(19,121)		(19,668)		(19,729)		(19,611)		(12,462)		(5,166)	
Promotions/Transfer payment							470		0		0	
Bad Debts	(58,163)		(61,288)		(111,152)		(127,649)		(80,881)		(25,432)	
Recoveries	8,219		14,780		27,428		30,253		42,431		54,750	
Net Yield	**112,827**	**5.63%**	**114,838**	**5.53%**	**81,201**	**3.95%**	**76,634**	**4.19%**	**77,070**	**8.93%** *	**79,003**	**12.41%**
Provisions for future losses	**0**		**0**		**(10,000)**							

*Funding Circle Net yield December 2021 - as principal has been withdrawn throughout the year this has been calculated as net earnings against the average of the opening and closing value. Note there was a large recovery received in June 2021 (£38,494) which has inflated this yield. Excluding this recovery the yield would be 6.4%

Fund Manager Selection

Investment Sub Committee Friday, 21 January 2022

Report of: Anna D'Alessandro – Chief Finance Officer (Section 151)
Purpose: For decision
Publication status: Unrestricted
Wards affected: All

Executive summary:

This report updates the Investment Sub Committee on the process to identify an appropriate set of investments to support the Council's medium-term financial objectives and propose an approach to future decision making for financial investments.

Building on the detailed analysis previously undertaken by the Council's treasury advisors, Link Group, and with their further support and guidance, this report proposes a conclusion to the Fund Manager Selection process to recommend the best future portfolio of investments.

This report supports the Council's priority of: Building a better Council/ Supporting economic recovery in Tandridge.

Contact officer Mark Hak-Sanders - Strategic Finance Business Partner (Corporate Finance)

Mark.HakSanders@surreycc.gov.uk

Recommendations to the Sub-Committee:

That the Sub Committee:

A) Notes the medium-term objective to balance a sustainable level of investment income against the stability of fund value, taking a considered approach to risk management in a changing investment environment.

B) Approves the strategy to provisionally retain current investments (excluding Funding Circle which will continue to wind-down) until a decision has been made by Government on whether to extend the current "statutory override" (para 2.3), which prevents gains and losses in capital value hitting the revenue budget.

C) If the override is not extended, approve disinvestment from these funds at a point where their capital value recovers to at least equal to the amount invested, or if it is clear that their capital value will not recover further:

- Schroders Credit Fund;
- UBS Multi Asset Fund; and
- CCLA Diversified Fund.

Note the intended strategy that, if the override is not extended, the Council intends to re-invest amounts in funds representing the best overall return (through combined capital value and revenue income), in a ratio considered proportionate with the overall fund size. Currently these would be as follows, but fund performance would need to be re-confirmed before any deposit was made. This will be reported back to Investment Sub Committee once a decision is made by Government:

- Royal London Assets Management (RLAM);
- Legal and General Investment Management (LGIM); and
- Newton Multi Asset Income Fund (Newton MAIF)

D) Approves the retention of the CCLA Property fund, offering strong capital and income performance and providing diversity to the overall portfolio.

E) Approves that the balance in the four funds should be retained at a level commensurate with latest projections of long-term cash availability and delegates authority to the S151 officer to amend the balances invested in the funds as necessary to retain a prudent working capital balance.

F) Note that the constitution delegates the execution and administration of treasury management decisions and borrowing strategy to the officer designated for the purposes of Section 151 of the Local Government Act 1972 (i.e. Chief Finance Officer).

Reasons for recommendations:

Having considered a number of alternate options, the recommended approach reflects the current uncertainty in Government policy.

In the longer term, the approach will:

- minimise the potential for losses which may become chargeable against the Council's revenue budget;
- maximise returns in the context of the potential for changes to the regulatory environment; and
- maintain a revenue income stream in line with the Council's ability to manage the risk of investment volatility.

1. Introduction and background

1.1. On 24th September 2021, the Investment Sub Committee considered a report from Link Group, the Council's treasury advisors, on potential options for the reinvestment of £1.3m previously redeemed from Funding Circle. The report also considered whether £12m already invested could be better placed in alternate funds.

1.2. The meeting on the 24th September 2021 concluded with a recommendation that "decisions on possible adjustments to the Council's investment portfolio be deferred until the Sub-Committee's next meeting, to be informed by a remodelled report from Link Group identifying the Council's short, medium and long-term investment position and supporting commentary from the Chief Finance Officer".

1.3. Subsequent to discussions with Link Group and officers it was agreed to produce this report in order to reconcile investment balances with updated balance sheet position and make further recommendations. This report therefore sets out the results of further consideration undertaken by the Chief Finance Officer, in consultation with Link Group and Surrey County Council's Treasury Management Centre of Expertise.

1.4. The report recommends that no immediate action be taken at present to amend or add to the Council's investment portfolio, including reasons why. The report sets out criteria that will, in future, be used to consider changes to the investment portfolio and commits to returning to Investment Sub-Committee should those criteria be met.

2. Key criteria for recommending funds

2.1. The key factors for assessing funds are as follows:

- Income performance – the typical percentage return on the amount invested, paid as an income on an annual basis;
- Capital performance – the likelihood of a fund retaining or growing the capital value invested over time;
- Size and sustainability of the fund – a larger fund would tend to indicate a lower risk profile and less volatility; and
- The Council's risk appetite to the three factors, above.

2.2. The Link Group report presented to the Investment Sub Committee in September did not recommend a set of funds to invest in because, in Link's view, it is a decision for officers and Members of the Council whether to prioritise revenue income, capital growth, or a combination of the two (total return).

2.3. This section sets out a recommended approach. In general, and over the medium-term, funds which offer the highest total return would seem to be the logical choice, however there are two factors which make the decision less straightforward:

- The Council's revenue budget relies on c.£500k per annum of income from the four funds currently holding £12m of investment (set out in Table 1). Given the current budget pressures, there is little room for manoeuvre in pursuing a strategy that would generate less revenue income. This budget requirement would steer the Council towards funds which maintain the current level of revenue budget performance.
- The current regulatory environment[1] means that the Council does not recognise annual gains and losses in the capital value of investments in the revenue budget, unless the investment is withdrawn. This is known as a statutory override, because it overrides usual accounting practice. The current override lasts until 31st March 2023. Government has not yet made a decision on whether to extend, amend or remove the override from that point. Because of this override, the capital performance of funds has been less of an immediate concern in the past.

2.4. The key criteria for recommending a fund are therefore:

- The annual return is maintained without taking risks to the revenue budget from volatile capital values [funds cannot be assessed for this until the future of the override is known]; and
- In the medium-term, the investment portfolio is based around total overall return, from funds that offer a sustainable approach to maintaining investment values.

[1] Regulation 30K of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 as amended by Regulation 5 of the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2018 (SI 1207/2018)

2.5. It is therefore recommended that, until the Government has made a decision on the future of the statutory override, the portfolio of investments remains as currently held. This is because the Council cannot determine the medium-term financial impact of changing funds until the future of the override is clear. For example, if the override is not extended, a focus on total return becomes the logical choice. If the override is extended, then income performance in the context of capital stability may be more preferable.

2.6. Recommendations B and C reflect the proposed approach to retain the current funds unless the override is ***not*** extended, in which case switch to a focus on total return.

2.7. Recommendation D proposes retaining the CCLA Property fund investment irrespective, since this offers diversity (representing a different type of investment to the remaining funds) and has performed reasonably well as a total return, as set out in the Link Group report.

3. Current funds

3.1. The Council currently has £12m invested in four funds set out in Table 1, below. Performance of each fund can be judged by the income they generate and by changes in their capital value over time.

3.2. The income provided by each fund in 2020/21 and forecast for 2021/22 is set out for context on income and yield. Two of the funds currently have an investment value lower than the amount invested. The fund value at 31st March 2021 (the balance sheet date) and 31st December 2021 (most recent valuation) are also included in the table.

Table 1 – Capital value and yield of each fund

Investment	Amount invested	Net Asset Value 31/03/21	Value Surplus / (Shortfall) at 31/03/2021	Yield Rate 2020/21	Actual Return 2020/21
	£	£	£	%	£
CCLA Property Fund	4,000,000	4,158,183	158,183	4.33	179,910
Schroders Credit Fund	3,000,000	2,908,911	(91,089)	4.32	125,529
UBS Multi Asset Fund	3,000,000	2,777,398	(222,602)	5.05	140,171
CCLA Diversification Fund	2,000,000	1,955,874	(44,126)	3.17	62,069
Total	**12,000,000**	**11,800,366**	**(199,634)**	**4.30%**	**507,679**

Investment	Amount invested	Net Asset Value Current at end of December	Value Surplus / (Shortfall) at 31/12/2021	Forecast Yield Rate 2021/22	Forecast Return 2021/22
	£	£	£	%	£
CCLA Property Fund	4,000,000	4,672,521	672,521	3.37	157,400
Schroders Credit Fund	3,000,000	2,915,856	(84,144)	4.38	127,600
UBS Multi Asset Fund	3,000,000	2,772,075	(227,925)	4.79	132,800
CCLA Diversification Fund	2,000,000	2,110,463	110,463	2.59	54,600
Total	**12,000,000**	**12,470,915**	**470,915**	**3.79%**	**472,400**

3.3. If the Council were to end its investment in Schroders Credit fund and the UBS Multi Asset fund, the combined (current) reduction in carrying value of £312k would be charged as a loss to the revenue budget. The Council's current budget and reserves position does not support this as an option. This loss would also be charged if the statutory override ended.

3.4. The only means of mitigating the full loss on disposal would be to simultaneously redeem the investment in the CCLA Property fund to take advantage of its increased capital value. It is not recommended to take that option at present for the reasons set out in section 2.7, above.

3.5. It is therefore recommended to remain in these funds until their capital value has recovered to at least equal to the amount invested.

4. How much should be invested

4.1. The current amount invested in the funds under consideration amounts to £12m.

4.2. The Link Group report sets out that at the 31st March 2021, £23m was currently available for investment. This has been reconciled to the Draft Statement of Accounts as follows:

Table 2 – Reconcile Available Balances to Statement of Accounts

	£000
Balance Sheet - Total Reserves	27,653
Add Provisions - the cash backing these is available for investment	2,001
Less Collection Fund Reserve - unavailable for investment as is distributed each year	(6,656)
Subtotal (including rounding adjustment)	**22,999**

4.3. The medium-term cash projections are as follows, comparing the trajectory included in the Link Group report in September, compared to the most recent update. Based on the cash projections in September, particularly for 2021/22, Link recommended that £12m was too high an investment balance for the funds in question. The revised projections show a smoother medium-term balance with a less pronounced dip in 2021/22. This adds weight to the conclusion that the current values can be retained. If cash projections reduce or increase significantly, recommendation E gives delegated authority to the S151 officer to change the balances invested, accordingly.

Table 3 – Updated cash flow projections

	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000
ISC Report 24th September	22,999	16,577	18,311	23,412
Latest	22,999	18,447	18,846	24,264
Movement	**0**	**1,869**	**535**	**853**

4.4. The main reasons for the increase in cash balances are:

- Slippage on the capital programme, particularly Quadrant House (£1.7m) and Disabled Facilities Grants (£0.2m); and
- Revised phasing of capital receipt balances

Note that the request to DLUHC to use capital receipts to meet the c£920k pension budget error has no effect on projected cash balances, since it replaces the use of one reserve (the General Fund) with another (the Capital Receipts Reserve). It does not change the level of cash flow into or out of the Council.

4.5. Currently there is a significant degree of uncertainty in the short, medium and long-term cash position. This uncertainty supports the recommendation to retain the status quo. In the short-term, volatility arises from significant cash receipts in respect of Covid-19 reliefs that are passed on to businesses. In the medium to long-term, available cash will depend on a number of factors including the delivery of the Redstone receipt and any decisions made concerning its use.

5. Other options considered

5.1. Across the eight funds under consideration, only CCLA Property makes the cut in all options considered. The three main options are to pursue:

- Revenue income;
- Capital gain; and
- Total return.

As discussed, without the statutory override, total return would be most appropriate course of action, but this decision cannot be made without further clarity from Government, and at this stage we do not know when this is likely to be.

6. Consultation

6.1. Link Group and the Surrey County Council Treasury Management Centre of expertise were consulted in setting out the recommended approach.

Key implications

7. Comments of the Chief Finance Officer

7.1. A full Balance Sheet review has been undertaken of the Council's borrowing and investments. The continuing approach to the Council's use of internal borrowings as a source of cash for the Capital Programme (rather than being reliant on external borrowing) in the current environment is deemed prudent.

7.2. The Committee should continue to take a holistic view of its investment portfolio to determine if any changes are required as a result of the fund manager selection process as set out in the Link Group report, and future Government decisions on the regulatory environment.

8. Comments of the Head of Legal Services

8.1. The appointed fund manager(s) will need to operate within a framework of prudence and fiduciary duty.

8.2. Arrangements should be in place for the formal measurement of performance of the investments and fund managers. The appointed fund managers should provide a quarterly report on activity, to be summarised by officers and presented to this Committee.

9. Climate change

9.1. There are no significant environmental/sustainability implications associated with the report. It is however recognised that some Council investments may be in companies that are considered to have a detrimental impact on the climate, for example oil companies.

Appendices

Appendix 'A' – Link Group – TDC Review of Treasury Management Activity

Background papers

Fund Manager Selection - Investment Sub Committee – 24 September 2021

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LINK Group

Tandridge District Council

Review of Treasury Management Activity

September 2021

Introduction

The Council wishes to review its Treasury Management activity in a holistic approach to see if the current approach which has been adopted is still appropriate going forward. The analysis also included the review of the current external fund managers, if they are still appropriate and meet the requirement of the Council and if the level of balance invested in longer term still viable.

Balance Sheet Position

When advising the Council on borrowing and on investment strategy, the first starting point is the balance sheet position, this helps to identify the level of cash balances and borrowing requirements.

We have undertaken the balance sheet review for the Council for 2020/21, which is included in Appendix 1 in its entirety, however, the tables below show the breakdown of the balance sheet.

Capital Financing Requirement & Borrowing:

Summary Balance Sheet Review	2018-19 £000	2019-20 £000	2020-21 £000
Capital Financing Requirement	74,087	107,121	108,369
less: External Borrowing	87,288	104,615	100,365
Under /(Over) Borrowing	(13,201)	2,506	8,004
Reserves / Balances available for investment	19,444	20,088	22,999
less: external Investments	35,385	22,244	24,228
Surplus Monies	(15,941)	(2,156)	(1,229)
Working Capital Surplus	**2,740**	**4,662**	**9,233**

Based on the balance sheet it shows that the Council had a Capital Financing Requirement (CFR, this is the underlying need to borrow for capital purposes i.e. capital expenditure net of all capital receipts, grant, revenue contributions to capital outlay etc.) of £108m as at 31st March 2021, which was an increase of £1.2m from the previous year. The Council had external borrowing of £100m, which meant £8.4m was financed through internal borrowing.

Reserves and Balances and Investments

Reserves & Balances	2018-19 £000	2019-20 £000	2020-21 £000
General Fund Balance	2,326	2,242	2,243
Housing Revenue Account Balance	750	750	2,796
Collection Fund Adjustment Account	(322)	(75)	(6,656)
Earmarked reserves/other balances	9,340	7,462	12,772
Capital Receipts Reserve	3,569	2,961	3,380
Provisions (exe. Accumulating absences)	456	1,121	2,001
Capital Grants Unapplied	3,325	5,627	6,463
Amount Available for Investment	**19,444**	**20,088**	**22,999**

Investments	2018-19 £000	2019-20 £000	2020-21 £000
Short - Term	11,734	10,903	14,592
Long - Term	6,306	5,992	6,114
Cash & Cash Equivalents	17,345	5,349	3,522
Total Investment	**35,385**	**22,244**	**24,228**

The Council had £23m of reserves and balances and £9.2m of working capital, less the £8.4m of internal borrowing, meant that at year end the Council had external investment position of £24m.

Summary Balance Sheet Position – 31st March 2021

The investment position on the Balance Sheet can be explained in summary through the following table:

	2018-19 £000	2019-20 £000	2020-21 £000
Reserves & Balances	19,444	20,088	22,999
Under / (Over) Borrowing	(13,201)	2,506	8,004
Working Capital Surplus	2,740	4,662	9,233
Total Investment	**35,385**	**22,244**	**24,228**

Current Debt and Investment Position

Debt Portfolio

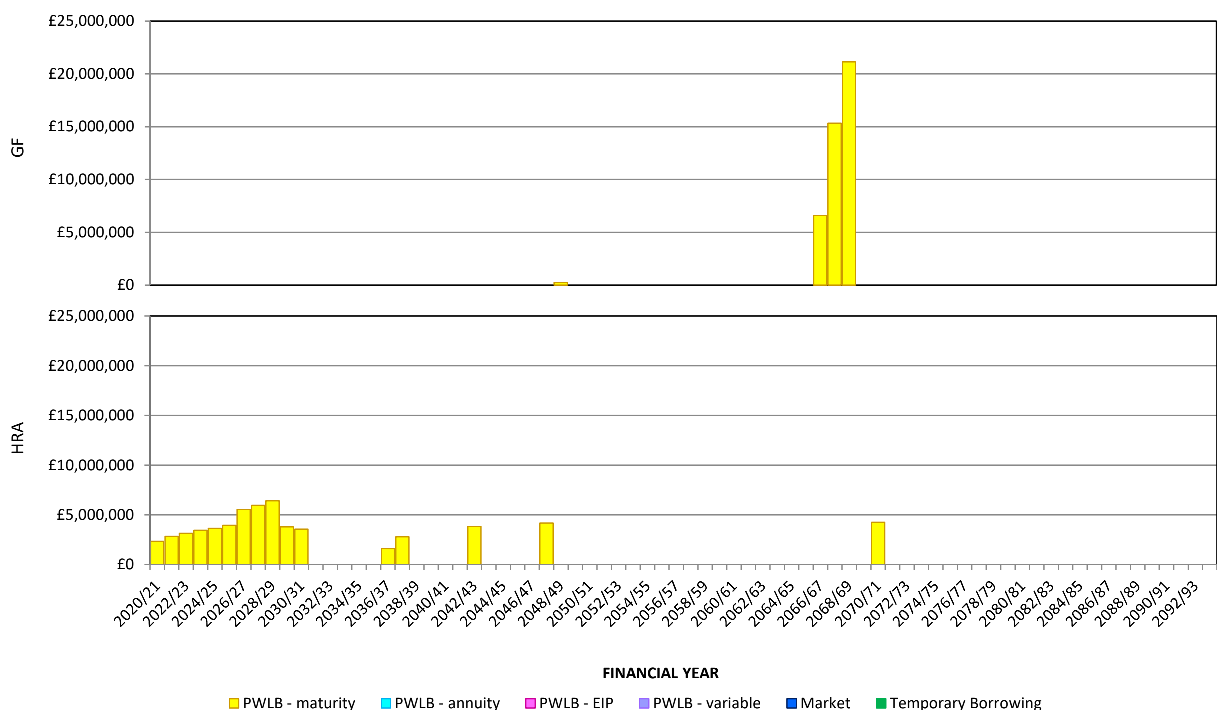
The current debt portfolio of the Council is £104.615m of Public Works Loan Board (PWLB) loans of which £61m is Housing Revenue Account (HRA) debt. It operates a two pool approach.

The HRA portfolio has an average rate of 2.785% and an average life of 12.38years. The portfolio has loans maturing each year, which will be refinanced in accordance with the HRA business plan.

The General Fund (GF) portfolio has an average rate of 2.49% and an average life of 47.55years.

The Council had budgeted borrowing cost at 2.5% for 2020/21. The £8m of internal borrowing as at 31st March 2021 meant that the Council generated a net borrowing cost saving of £192k (assuming loss of investment income at 0.10%)

Current Maturity Profile



The Council has now replaced the £4.250m HRA loan which matured in March 2021 with a 50 year PWLB loan at an interest rate of 1.91% which is 30bps cheaper than the previous loan, therefore generating interest cost saving of £12,750 per annum.

Investment Portfolio

The current investment portfolio of the Council as at the end of June 2021 was £25.988m, of which £12m (original principal) is invested with external fund managers and the remaining is managed in-house.

The £12m which is managed externally has been split in the following managers:

- CCLA Property Fund - £4m
- Schroders Credit Fund - £3m
- CCLA Diversified Income Fund - £2m
- UBS Multi-Asset Income Fund - £3m

This element of the portfolio is the long term focussed, with the Property Fund having the longest investment time horizon of 5-10 years+, multi-asset funds typically 5yrs+ and the Council's bond fund

3-5yrs. When decision was taken to invest in these funds, the Council had identified this element of cash as core which could be invested over a longer time horizon.

Based on the balance sheet review as at the 31st March 2021, which shows the Council has £24m of external investment, this confirms that Council still has scope to maintain this level of cash invested in longer term focussed investments.

Returns on these funds are driven by two elements, income and movements in underlying capital values. Whilst the capital value is based on the unrealised gains/losses of the fund, which under IFRS9 would have a direct impact on the GF reserves, the CIPFA override currently removes this risk. The CIPFA override was put in place for 5 years, due to expire in 2022/23 unless it is extended.

The following table outlines the investment income that the Council has received in the last five years from its funds. The columns show the actual income received from each fund for each financial year and then the yield, which is calculated by dividing the income amount by the capital value of each fund at year-end.

Gross Revenue Yield	2016/17		2017/18		2018/19		2019/20		2020/21	
	Income	Yield	Income	Yield	Income	Yield	Income	Yield	Income	Yield
	£	%	£	%	£	%	£	%	£	%
CCLA Property Fund	164,434	4.03%	193,758	4.53%	183,989	4.30%	185,240	4.42%	179,910	4.33%
Schroders Bond Fund	127,340	4.30%	105,413	3.62%	120,508	4.21%	124,418	4.90%	125,529	4.32%
UBS Multi Asset Fund	100,600	3.33%	146,788	5.03%	116,513	4.06%	137,531	5.46%	140,171	5.05%
CCLA Diversification Fund	n/a	n/a	62,732	3.27%	67,030	3.38%	66,284	3.67%	62,069	3.17%
Total	392,375		508,691		488,040		513,473		507,679	

Year-end capital values for each of the funds are provided in the table below:

Market Value	2016/17	2017/18	2018/19	2019/20	2020/21
	31.3.2017	31.3.2018	31.3.2019	31.03.2020	31.03.2021
	£	£	£	£	£
CCLA Property Fund (mid-market value)	4,082,986	4,276,854	4,276,005	4,188,063	4,158,183
Schroders Bond Fund	2,963,563	2,912,837	2,865,130	2,539,938	2,908,911
UBS Multi Asset Fund	3,018,705	2,918,160	2,868,479	2,520,713	2,777,398
CCLA Diversification Fund (indicative market value)	n/a	1,921,257	1,982,167	1,804,193	1,955,874
Total	10,065,254	12,029,108	11,991,781	11,052,907	11,800,366

As at 30th June 2021 the Council had £13.257m managed in-house. The portfolio was managed using a combination of Money Market Funds (MMFs) and Ultra-Short-Dated Bond Funds (USDBFs). This provides the Council with a high level of liquidity while the underlying short-term nature of the investments within these funds is reflected in their low yields.

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest LT / Fund Rating	Historic Risk of Default
MMF Aberdeen Standard Investments	5,000	0.01%		MMF	AAAm	
MMF CCLA	4,000,000	0.03%		MMF	AAAm	
MMF Goldman Sachs	5,000	0.00%		MMF	AAAm	
MMF Invesco	1,205,000	0.01%		MMF	AAAm	
MMF Morgan Stanley	4,000,000	0.03%		MMF	AAAm	
USDBF Federated Sterling Cash Plus Fund	2,040,381	0.11%		USDBF	AAAf	
USDBF Insight Liquidity Plus	2,001,464	0.01%		USDBF	AAAf	
Borrower - Funds	**Principal (£)**	**Interest Rate**	**Start Date**	**Maturity Date**		
CCLA Property Fund	4,000,000					
CCLA Diversified Income Fund Class 2 Units - Income	2,000,000					
UBS Multi Asset Income Fund (Class L Shares Inc)	3,000,000					
Schroder Strategic Credit L Income Fund	3,000,000					
Funding Circle	731,156					
Total Investments	**£25,988,000**					
Total Investments - excluding Funds	**£13,256,844**	**0.04%**				-
Total Investments - Funds Only	**£12,731,156**					

The investment balance is higher than usual due to the high Government support provided as a result of the Pandemic.

Fund Manager Selection Process

Following the decision to unwind the £2m invested in the Funding Circle, the Council wanted to look at options available for longer term investment. The Council employed Link to support it in undertaking a fund manager selection process. The focus of this was on the multi-asset fund class, where the Council already had previous experience of their use and given that they aim to provide investors relatively high levels of income within overall returns in addition to liquidity and a strong level of underlying diversification. As outlined above, the Council already uses two such funds, CCLA Diversified Income Fund and the UBS Multi-Asset Income Fund.

The Council had first invested in the UBS fund in October 2015 and added to this initial position in September 2016. For the CCLA fund, the Council made one investment in April 2017. Given the length of time since these investments had been made, the Council decided it would be opportune to review a wider range of potential fund options, to ensure that it made the most appropriate decision on where to invest going forward, including whether its existing managers were still fit for purpose.

A total of seventeen suitable managers were asked to complete a detailed questionnaire on their proposed multi-asset fund. Of these, four managers declined to participate, including UBS, who cited a lack of available personnel due to summer holiday commitments to be able to complete the questionnaire in a suitable and timely manner.

From the eventual long list of funds, the Council chose Fidelity, Legal & General, Newton and Royal London to attend a presentation day to outline their funds in more detail. Note that CCLA, having completed the questionnaire process, were deliberately not included in the presentation process. The primary reason for this was that officers were comfortable that they already had a full understanding of the fund that would allow suitable comparison against alternatives. In addition to reviewing the funds in their own right, the process focussed on how each might “fit” into the Council’s overall investment portfolio.

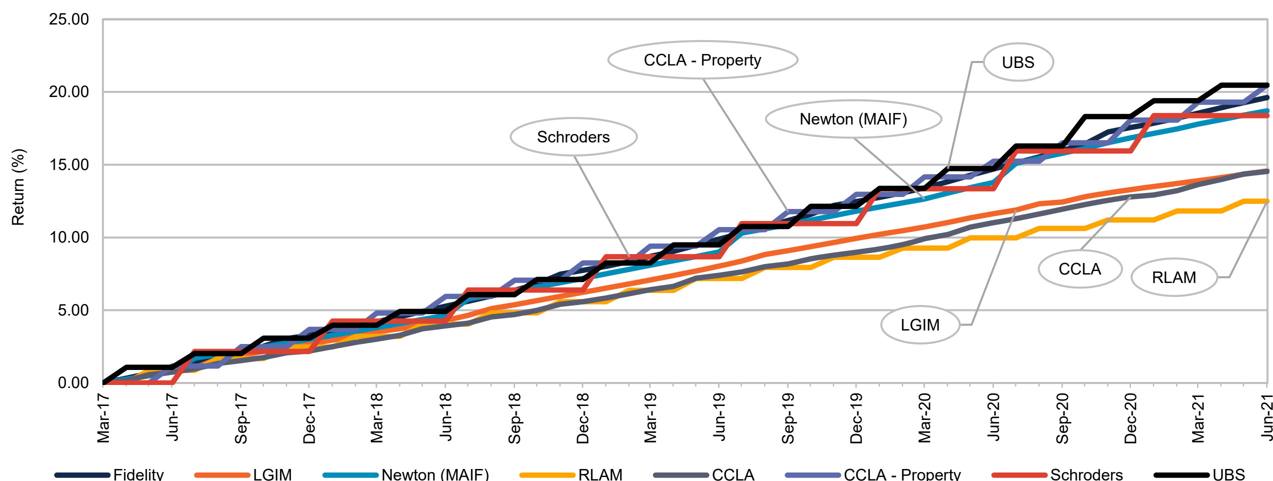
The following table provides periodic performance information spanning from one month to five years for the period ending June 2021. It breaks down overall performance (total return) into its component parts of income and capital, thus allowing for more detailed analysis of the main drivers. The top section provides details on the four funds invited to present to Council officers in early September. Meanwhile, the bottom section provides the same details for the four longer-term funds that the Council already invests with. Average figures, covering existing and potential new funds are presented in the middle of the table.

Cells colour-coded red in the table indicate a level that is below the overall average, while those coloured green indicate above average performance. Note also that some funds pay income periodically, so may not show figures in either the one, or three-month columns. Please also note that figures beyond one year are annualised, while those out to six months are not.

It is important to stress that while the bulk of funds detailed below are from the multi-asset class, the data also includes the CCLA property fund and the Schroders Fixed Income Fund. While data has been shown on a comparator basis, outright performance is not necessarily the only factor that needs to be considered. For example, the liquidity available in a property fund is far less than other funds, which are typically redeemable within a few days’ notice. Further, the diversification benefits of not having longer-term investments all focussed in one asset class could be a consideration when reviewing the overall longer-term investment portfolio approach. Another consideration is the split between income and capital that these differing funds provide, where the table shows how funds can provide consistently above average income returns while capital performance is weaker than that seen across the fund mix.

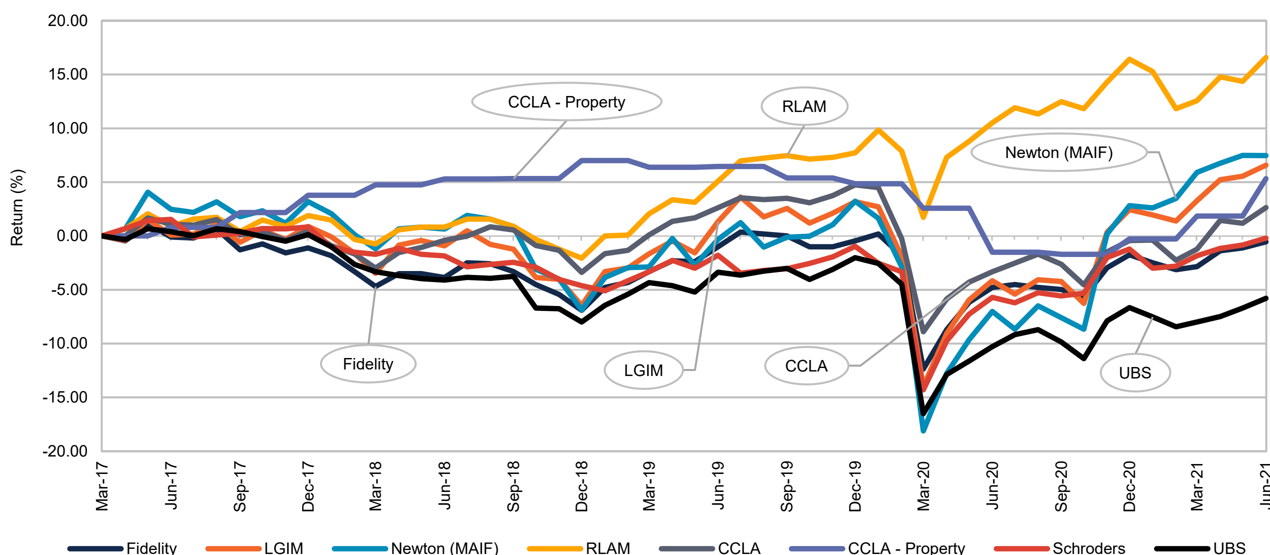
	Return	1M (%)	3M (%)	6M (%)	1YR (%)	3YR (%) *	5YR (%) *	Fund Size (£m)	Fees (OCF %)
Selected Funds for Final Presentation Day									
Fidelity (Apr 2007)	Total	0.86	3.30	3.00	8.95	5.55	5.38	1,250.37	0.58
	Capital	0.56	2.37	1.22	4.45	1.14	0.91		
	Income	0.30	0.90	1.75	4.29	4.35	4.42		
LGIM (Oct 2015)	Total	1.18	3.81	5.23	14.12	5.72	6.61	103.33	0.31
	Capital	0.97	3.19	4.04	11.21	2.46	3.24		
	Income	0.20	0.60	1.14	2.64	3.18	3.27		
Newton (MAIF) (Feb 2015)	Total	0.23	2.28	6.19	20.56	6.59	8.31	132.16	0.70
	Capital	-0.02	1.48	4.53	15.58	2.21	3.99		
	Income	0.26	0.78	1.60	4.34	4.30	4.18		
RLAM (Dec 2012)	Total	1.94	4.19	1.30	7.92	7.73	7.43	1,150.34	0.569
	Capital	1.94	3.57	0.14	5.50	4.96	4.51		
	Income	0.00	0.60	1.16	2.29	2.64	2.79		
Average Across All Funds	Total	0.90	3.35	4.49	13.17	5.19	6.08	-	-
	Capital	0.68	2.44	2.79	9.09	1.29	2.15		
	Income	0.22	0.89	1.66	3.74	3.85	3.85		
Funds Already Invested In									
CCLA (Dec 2016)	Total	1.60	4.74	4.67	9.54	4.34	-	138.60	1.23
	Capital	1.44	3.91	3.07	6.17	1.01	-		
	Income	0.15	0.80	1.55	3.17	3.29	-		
CCLA Property (Jan 1963)	Total	-	4.39	7.74	11.73	4.39	5.93	1,253.50	-
	Capital	-	3.43	5.63	6.94	0.01	1.37		
	Income	-	0.99	2.05	4.55	4.38	4.51		
Schroders (Apr 2006)	Total	0.65	1.67	3.19	10.64	5.01	4.64	641.23	-
	Capital	0.65	1.67	1.02	5.83	0.56	0.22		
	Income	0.00	0.00	2.10	4.44	4.33	4.31		
UBS (Oct 2009)	Total	0.97	3.31	2.78	10.32	4.15	3.58	40.31	-
	Capital	0.97	2.39	0.92	5.00	-0.60	-0.87		
	Income	0.00	0.89	1.83	5.00	4.72	4.44		

The Council will, therefore, need to balance a wide array of different considerations when deciding what mix of funds will be most appropriate for it moving forwards. For example, if the primary focus is seen as solely income, and consistency of income, then it may look to just those funds which produce the strongest levels. The following chart provides details on the cumulative income performance of all of the funds included in the table above.



This would suggest that, over the longer term, the multi-asset fund from LGIM (Legal & General Investment Management), the CCLA Diversified Income Fund and the Royal London multi-asset fund while providing consistency of income, it is at a lower rate than that of the other funds under consideration. This chart uses April 2017 as its starting point (March is point 0) as this was the date when the Council made its most recent investment in a multi-asset fund (CCLA). While the timing of income distribution provides different profiles for the other funds, the chart would suggest that, over the longer term, they do provide greater overall levels of distributions to investors.

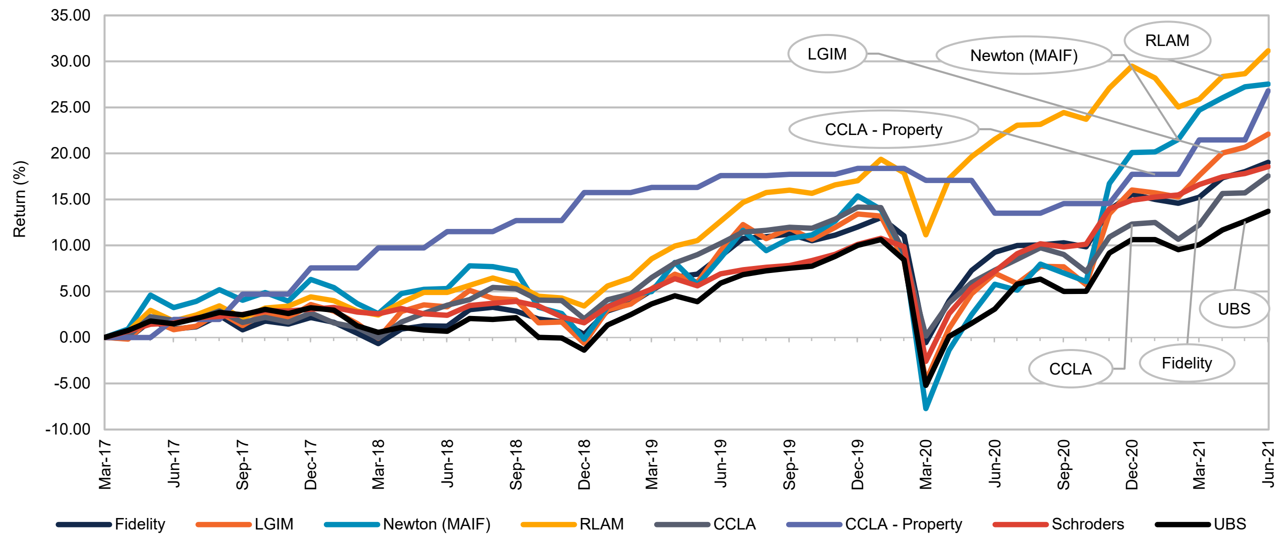
However, the Council should still consider whether this income is being generated at too great an expense in terms of capital performance and thus affecting overall returns in the longer term. The following chart provides the cumulative progress of capital of the funds under review over the same time period as the income chart above:



In contrast to the income chart, this chart shows that the weakest overall capital performance has come from UBS, with Royal London some way ahead of other funds under review. It also shows the potential diversification benefits of utilising funds from a range of asset classes. In this instance, the CCLA property fund was far less impacted through 2018 than other funds under review when markets were increasingly concerned about the global economic outlook. More recently, it shows the clear, but in some cases notably different impact of the pandemic upon market pricing. Least affected was Royal London, where its capital value returned to pre-pandemic levels by June 2020. This reflected the more conservative approach of the fund in terms of both its weighting towards equities (lower than that of

other multi-asset funds under review) and greater focus on higher quality fixed income instruments. The CCLA property fund did see a weaking of its capital levels, but it was a more drawn-out process than the steep, sharp falls seen in most other funds. While the Schroders fund is fixed income focussed, it is allowed to invest more than 50% in sub investment grade bonds, which will typically be more affected by economic downturns than higher credit qualities, thus providing a more equity-like performance profile in capital movements during the height of the pandemic in 2020.

The final chart combines the income and capital performance on a cumulative basis. While UBS and Royal London have the strongest and weakest income elements to their performance, this is outweighed by what has happened in terms of capital movements for the respective funds through the period under review. The overall economic improvement seen through the latter stages of 2020 and into 2021 has benefitted all funds, with Newton seeing the strongest "rebound" from the depths of the pandemic impact. Evidently (and hopefully) pandemics are not regular occurrences for financial markets and economies to deal with. However, markets still move in cycles and while the income chart above would suggest that the impact on income is more limited, it does have a more material impact on capital movements. It is, therefore, important for the Council, when making its decision on the most suitable profile of funds to use in the future, to also consider how different funds can be affected through the different stages of an economic cycle and importantly how quickly they can recover. This could come into greater focus in the future if the current situation where the IFRS9 override forgoes capital movements (both up and down) to directly impact on balance sheet bottom lines. Similarly, while strong capital returns may allow an investor to "top slice" performance in any given period to support income, the volatility of capital movements is greater than that of income, even for more conservative focussed funds, means that this option is not assured.



Interest Rate Forecast

LINK GROUP FORECASTS

We do not think that the MPC will embark on a series of increases in Bank Rate of more than 0.50% during the current and next two financial years as we do not expect inflation to return to being sustainably above 2% during this period.

With unpredictable virus factors now being part of the forecasting environment, there is a risk that forecasts could be subject to significant revision during the next three years.

Gilt yields and PWLB rates

The general situation is for volatility in bond yields to endure as investor fears and confidence ebb and flow between favouring relatively more "risky" assets i.e., equities, or the safe haven of government bonds. The overall longer-run trend is for gilt yields and PWLB rates to rise.

There is likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates due to the following factors: -

- How strongly will changes in gilt yields be correlated to changes in US treasury yields?
- Will the Fed take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong will inflationary pressures turn out to be in both the US and the UK and so impact treasury and gilt yields?
- How will central banks implement their new average or sustainable level inflation monetary policies?
- How well will central banks manage the withdrawal of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets as happened in the "taper tantrums" in the US in 2013?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

Our forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within our forecasting period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

Link Group Interest Rate View		10.8.21								
	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	0.25	0.25	0.25	0.50
3 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.30	0.30	0.30	0.50
6 month ave earnings	0.10	0.10	0.10	0.10	0.10	0.10	0.20	0.30	0.40	0.50	0.50
12 month ave earnings	0.20	0.20	0.20	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.70
5 yr PWLB	1.20	1.20	1.20	1.30	1.30	1.30	1.40	1.40	1.40	1.50	1.50
10 yr PWLB	1.60	1.60	1.70	1.70	1.80	1.80	1.90	1.90	1.90	2.00	2.00
25 yr PWLB	1.90	2.00	2.10	2.20	2.30	2.30	2.30	2.40	2.40	2.40	2.50
50 yr PWLB	1.70	1.80	1.90	2.00	2.10	2.10	2.10	2.20	2.20	2.20	2.30

Balance Sheet Projections

Link use the Balance Sheet Review as a foundation to develop a forward projection which can be used as a strategic planning tool to inform the treasury management strategy over the medium term. Each key component from the Balance Sheet Review is projected forward to ascertain the potential impact of the capital programme, known movements in the external borrowing portfolio and expected movements in reserves and balances and working capital on the treasury management strategy of the Council. The movement of each of these elements has a direct impact on the forecast cash position of the Council and therefore the cumulative impact can be summarised to help inform both future investment and borrowing decisions.

This will be updated as and when new information becomes available and can provide a framework as to what is appropriate for the forecast financial position of the Council over the medium term, which can then be discussed in the context of the risk appetite of the Council.

The forward projections produced below is an initial draft based on the information currently available.

2019/20 (£'000)	CAPITAL FINANCING REQUIREMENT	2020/21 (£'000)	2021/22 (£'000)	2022/23 (£'000)	2023/24 (£'000)
45,813	GF	47,061	49,637	49,059	48,285
61,308	HRA	61,308	65,040	67,389	67,389
107,121	CFR	108,369	114,677	116,448	115,674
-	Finance Lease Liabilities	-	-	-	-
107,121	Underlying Borrowing Requirement	108,369	114,677	116,448	115,674
(104,615)	External Borrowing c/fwd	(104,615)	(100,365)	(108,347)	(108,347)
-	Loan Maturities	4,250	2,350	2,850	3,150
-	New Loans	-	(10,332)	(2,850)	(3,150)
(104,615)	External Borrowing	(100,365)	(108,347)	(108,347)	(108,347)
2,506	Under / (Over) Borrowing	8,004	6,330	8,101	7,327
2%	*Underborrowing as a % of Underlying Borrowing Requirement*	*7%*	*6%*	*7%*	*6%*
	RESERVES / BALANCES, INVESTMENTS & WORKING CAPITAL (£'000)				
2,242	General Fund Balance	2,243	4,434	5,186	5,886
750	Housing Revenue Account Balance (inc MRA)	2,796	750	750	3,640
(75)	Collection Fund Adjustment Account	(6,656)	(6,656)	(6,656)	(6,656)
7,462	Earmarked reserves	12,772	7,396	7,546	7,893
2,961	Capital Receipts Reserve	3,380	2,144	2,244	2,344
1,121	Provisions (exc. any accumulating absences)	2,001	2,001	2,001	2,001
5,627	Capital Grants Unapplied	6,463	6,508	7,240	8,303
20,088	Amount Available for Investment	22,999	16,577	18,311	23,411
22,244	External Investments	24,228	14,247	14,210	20,084
4,662	Working Capital (Deficit) / Surplus	9,233	4,000	4,000	4,000

The Council's CFR is forecast to increase from £108m to £116m in 2022/23 and Reserves and Balances is expected to fall from current levels to £18m in the same year. Loans which were taken during the HRA self-financing in 2012, has loans maturing each year. The projection assumes refinancing of the HRA loan as they mature and the additional HRA expenditure expected in 2021/22.

This year, 2021/22, if the Council's CFR increases to £114m as per the projection, the external investment balance falls from £24m to £14m. This is based on the assumption that the Council only refinances the HRA borrowing and does not take any new external borrowing, and therefore maintain an internal borrowing position of £6.7m (6% of the CFR).

If the Council wishes to adopt the strategy to maintain 6% of its CFR in internal borrowing this will:

- Reduce credit and counterparty risk
- Reduce the cost of carry

- And generate a net borrowing cost saving of £107k per annum (based on borrowing cost at 1.70%(50yr PWLB borrowing rate) and money market interest rate of 0.10%)

However, it is important to recognise this strategy is a temporary measure and that regular review is required to ensure that when this position is converted the Council is borrowing at favourable borrowing rates.

The Council will need to consider the level of long term investment it has. Based on the projections outlined above, the external investment balance falls to £14m at end 2021/22 and to remain at this level the following year before rising to £20m in 2023/24. In the near-term, this would indicate that £12m in long term investments maybe deemed excessive.

Accounting Implications

The CIPFA Code of Practice (the Code) adopted IFRS 9 Financial Instruments in 2018/19 and requires the classification of financial assets as either:

- Amortised Cost
- Fair Value through other Comprehensive Income (FVOCI)
- Fair Value through Profit of Loss (FVPL)
- The classification is determined by two factors:
- the authority's business model for managing the financial assets, and
- the contractual cash flow characteristics of the financial asset.

IFRS9 Classification	Code Reference	Business Model	Contractual Cash Flows
Amortised Cost	7.1.5.2	The financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows	The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.
FVOCI	7.1.5.3	The financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets	The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding
FVPL	7.1.5.4	All other combinations of business model and contractual cashflows	

The Council's current treasury investments are a combination of MMFs, USDBF's, MAIF's, Bond Fund and a property fund, classified as either amortised cost or FVPL.

The statutory override in respect of pooled funds, which is due to last 5 years from 2018/19 to 2022/23, currently results in unrealised gains and losses from pooled funds being taken to a specific unusable reserve on the balance sheet. The consultation outcome issued by MHCLG back in 2018 states that the Government would continue to keep the override under review and that the 5 year time horizon provided local authorities with time to consider their investment strategies over the medium term. We await further information as to what will happen at the end of 2022/23 and the Council should assess the potential impact of the override not being extended when monitoring its current pooled fund investments and when considering any future long term investment decisions which may be considered going forward.

We would always suggest that the decision to enter into such investments should be based on the financial position of the Council and the recognition of the appropriate time horizon and underlying risks associated with the investment in question.

Summary

This report has reviewed the current balance sheet position of the Council as well as the forward projection in order to establish if the Council has capacity to place further money over the longer term investment time horizon. The Multi Asset Income Fund Selection also presented the Council with the opportunity to review if its current managers are still fit for purpose, or whether there are alternative options which could be more appropriate for its requirements.

The balance sheet forward projection assumes CFR to increase to £114m in 2021/22, external borrowing remaining at £108.35m, therefore having an internal borrowing position of £6.3m. The projection assumes that the level of Reserves and Balances falls from £23m to £16.5m which means the Council's external investment balance will fall to c.£14m at year-end.

In a low interest rate environment, it is deemed prudent to maintain an internal borrowing position as this reduces the cost of carry and generates a net interest cost saving (cost of borrowing less investment income).

However, if the Council's external investment balance is expected to fall to the levels outlined above, it raises the question as to whether the Council can maintain having £12m in longer term focussed investment funds. The current investment position has been split into the following funds (original principal, then position as at end-June 2021):

- CCLA Property Fund - £4m / £4,300645
- Schroders Credit Fund - £3m / £2,957,826
- CCLA Diversified Income Fund - £2m / £2,032,376
- UBS Multi-Asset Income Fund - £3m / £2,843,639

The Fund Selection process and the review of all the performance data of each of the funds outlined in the previous section provided the following information on funds:

CCLA Property Fund – capital level had declined but was back above starting point by close of 2020/21. While weaker than the overall average, the main driver of property funds is income, which had been consistent and higher than average levels across other funds under consideration at 4.51% over past 5yrs.

Schroders Credit Fund (fixed income) – capital level had declined by similar magnitude to multi asset funds in both 2018 and early 2020. However, had also reverted higher in a similar vein as market conditions and economic outlooks improved. While below the average, modestly positive gains of 0.22% per annum over past 5yrs. Income both consistent and higher than average (3.85%), at 4.31% per annum, over the past 5yrs.

CCLA Diversified Income Fund (multi asset) – capital performance had improved from the depths of the pandemic. However, at 1.01%, it was below the average of other funds over the past 3yrs (fund does not have a 5yr track record). While consistent, income lower than average (also 3.85%) at 3.29% over the past 3yrs. Fees also appreciably higher than alternate multi asset funds included within selection process

UBS Multi-Asset Income Fund – the weakest capital performance of funds under review at -0.87% per annum over the past 5yrs. Income consistent and above average at 4.44% per annum over the last 5yrs. At just over £40m, the smallest fund included within this review.

Fidelity (multi asset) – below average capital performance but as with bulk of its peer group, the focus of this fund is on income. Nevertheless, at 0.91% per annum over last 5yrs it was stronger than a number of other similar funds under review. Income consistently amongst the highest tier of funds under review and at 4.42% per annum, it was higher than the average over the last 5yrs. Fund approach is "fund of funds" rather than individual investments, with key part of its investment process researching and analysing potential fund options with which to execute its investment ideas. One of two funds included within the review that takes this approach across whole of its fund.

LGIM (multi asset) – above average capital performance over past 5yrs at 3.24% per annum vs average of 2.15%. Income performance consistent but within the lower tier of funds under review. 3.27% per annum over past 5yrs. The other fund of fund approach but focus on risk appetite of investors with a number of different funds in the range that look to achieve more definitive outcomes based on investor risk appetite.

Newton (multi asset) – At 3.99% per annum over past 5yrs, capital performance among the strongest of funds under review. Was one of the weakest performers at the peak of the pandemic impact but rebound thereafter amongst the strongest. Average income of 4.18% per annum over last 5yrs above average and within top tier of funds under review.

Royal London (multi asset) – Strongest capital performance of funds under review at 4.51% per annum over past 5yrs. This performance reflected the more limited immediate impact of the pandemic due to fund's heavier bias towards higher quality fixed income instruments (typically 75%). However, in downturn of 2018, fund's capital performance was much in-line with other multi-asset funds. This approach also reflects weakest income performance at 2.79% per annum over last 5yrs. Fund positions itself as more a "total return" product for investors with the ability to top slide capital performance (where available) to support income.

In terms of moving forwards, the Council needs to consider both its current internal position and where it believes it will progress in the future (as outlined in the forward balance sheet projection) when considering what mix of funds would be most appropriate for its needs. Barring the property fund, all existing funds, as well as the potential new options are liquid, meaning that subscriptions / redemptions can be made in a short space of time. However, if the Council did look to divest itself of any existing fund, it will need to also consider the current capital values, as any shortfall would be an immediate hit to its finances. As detailed above, both CCLA funds were above original principal amounts at the end of June 2021. Meanwhile, Schroders was just below its original principal amount and UBS was lower by over £150,000.

Discussions with officers over the internal position has identified a bias towards income generation for its longer-term investments. This would suggest that the three funds in the lower tier of income generation (CCLA Diversified Income Fund, LGIM and Royal London) may not be the most appropriate for the Council at the present time. While Royal London has provided the strongest overall performance in the review section above, the bulk of this has come from capital, which, as shown, is the more volatile element of total return. The concern would be that if the fund did not generate sufficient capital appreciation, then the Council's ability to support its revenue budget through income and top-slicing capital of this fund could be compromised.

In terms of those funds with higher levels of income, capital performance again could play a part in the future path of the Council's investment portfolio. As detailed above, over the five year period to end June, UBS, while providing robust income levels, has shown the weakest overall return, with its capital position still over £150k below the original balance invested. While other multi-asset funds have seen similar shortfalls through the review period, they have seen capital bounce back. UBS has achieved a capital return of -0.87% per annum over the past 5 years, with the next weakest performance over 100 basis points higher (Schroders at 0.22%), per annum. Note that the difference in income performance is just 13 basis points, in favour of UBS. The four remaining funds, CCLA Property, Schroders Credit, Newton and Fidelity through the review period have combined higher tier income with more supportive capital profiles. They also maintain the Council's current diversification between investments in different asset classes. If the Council wished to move forwards using these funds then, as outlined above, it would need to consider its balance sheet position and potential exit strategy as part of any reallocation process.

Link would welcome the opportunity to discuss this report and support the Council in making its decision on future investment in more detail.

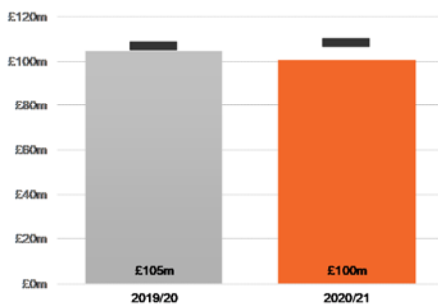
Appendix 1

TANDRIDGE DISTRICT COUNCIL
2020/21 Desktop Balance Sheet Review

CAPITAL FINANCING AND BORROWING (£'000)	2019/20	2020/21
Capital Financing Requirement (CFR)	107,121	**108,369**
Underlying Borrowing Requirement	107,121	**108,369**
External Borrowing	104,615	**100,365**
Internal Borrowing	2,506	**8,004**
Net Borrowing (exc TFR debt)	82,371	**76,137**
CFR per Statement of Accounts	106,936	**108,286**

2019/20 (£'000)		2020/21 (£'000)	Change (£'000)
	Capital Financing Requirement (CFR)		
355,706	Property, Plant & Equipment	380,042	
21,680	Investment Property	6,170	
1,727	Intangible Assets	1,871	
21,991	Capital Investments (non-TM)	21,493	
(164,691)	Revaluation Reserve	(174,151)	
(129,292)	Capital Adjustment Account	(127,056)	
107,121	**CFR (as per Prudential Code)**	**108,369**	**1,248**
107,121	**Underlying Borrowing Requirement**	**108,369**	**1,248**
	External Borrowing		
(4,250)	Short-Term	(2,350)	
(100,365)	Long-Term	(98,015)	
(104,615)	**TOTAL External Borrowing (Principal)**	**(100,365)**	**4,250**
2,506	Internal Borrowing	8,004	5,498

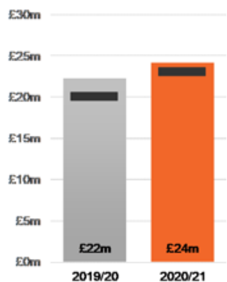
External Borrowing vs Underlying Borrowing Requirement



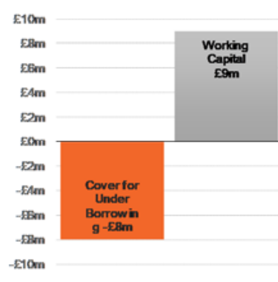
RESERVES / BALANCES AND INVESTMENTS (£'000)	2019/20	2020/21
Balances Available for Investment	20,088	**22,999**
External Investments	22,244	**24,228**
Surplus Monies	(2,156)	**(1,229)**

2019/20 (£'000)		2020/21 (£'000)	Change (£'000)
	Reserves / Balances		
(2,242)	General Fund Balance	(2,243)	
(750)	Housing Revenue Account Balance	(2,796)	
75	Collection Fund Adjustment Account	6,656	
(7,462)	Earmarked reserves / other balances	(12,772)	
(2,961)	Capital Receipts Reserve	(3,380)	
(1,121)	Provisions (exc. any accumulating absences)	(2,001)	
(5,627)	Capital Grants Unapplied	(6,463)	
(20,088)	**Amount Available for Investment**	**(22,999)**	**(2,911)**
	Investments		
10,903	Short-Term	14,592	
5,992	Long-Term	6,114	
4,520	Cash & Cash Equivalents - Investments / Deposit	3,250	
829	Cash & Cash Equivalents - Other (Bank / Cash)	272	
22,244	**TOTAL Investments**	**24,228**	**1,984**
2,156	Surplus Monies	1,229	(927)

Investments vs Balances



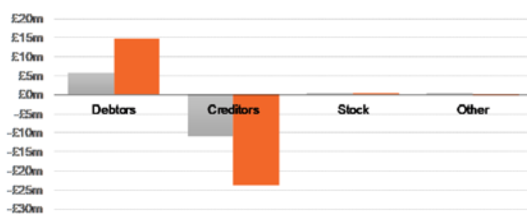
Analysis of Surplus Monies



WORKING CAPITAL (£'000)	2019/20	2020/21
TOTAL Working Capital (Surplus)	(4,662)	**(9,233)**

2019/20 (£'000)		2020/21 (£'000)	Change (£'000)
	Working Capital		
5,787	Debtors	14,666	8,879
(10,978)	Creditors	(23,679)	(12,701)
85	Stock / WIP	83	
(5,106)	**NET Working Capital (Surplus)**	**(8,930)**	**(3,824)**
	Other		
113	Balance LT Debtors	113	
(650)	Balance of LT Liabilities	(650)	
981	FIAA - Premiums, (Discounts) etc	-	
-	Pooled Investment Funds Adjustment Account	234	
444	**Other Long-Term Working Capital**	**(303)**	**(747)**
(4,662)	TOTAL Working Capital (Surplus)	(9,233)	(4,571)

Analysis of Working Capital



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Capital, Investment and Treasury Management Strategy

Investment Sub Committee Friday, 21 January 2022

Report of: Chief Finance Officer (Section 151)

Purpose: For decision

Publication status: Unrestricted

Wards affected: All

Executive summary:

This report submits the updated Capital, Investment and Treasury Management Strategy in accordance with the Department for Levelling Up, Housing and Communities (DLUHC) and CIPFA guidance to this Sub Committee for approval before going forward to full Council on 10th February 2022 for approval.

This report supports the Council's priority of: Building a better Council/ Creating the homes, infrastructure and environment we need/ Supporting economic recovery in Tandridge/ Becoming a greener, more sustainable District.

Contact officer Mark Hak-Sanders – Strategic Finance Business Partner (Corporate Finance)
Mark.HakSanders@surreycc.gov.uk

Alison Boote – Executive Head of Communities
aboote@tandridge.gov.uk

Recommendation to the Sub-Committee:

That the Sub Committee recommends to Council the approval of the Capital, Investment and Treasury Management Strategy

Reason for recommendation:

This report and separate document will be reviewed by this Sub Committee before being recommended to Council for approval. This is a requirement of the CIPFA 2017 Prudential and Treasury Management Codes.

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1 Introduction and background

1.1 The Capital, Investment and Treasury Management Strategy ('Strategy') have been updated and is attached as a separate document. This strategy provides a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the delivery of the Council's priorities along with an explanation of how risk, security and liquidity are managed.

1.2 The aim of the Strategy is to provide a framework within which the Council's Capital Investment Plans will be delivered. It provides a summary of the Council's capital expenditure plans and financing along with the principles, sources of finance and governance arrangements which apply to the management of the Capital Programme.

1.3 The Strategy also covers the Treasury Management function which main aim is to ensure that the income raised during the year is sufficient to meet expenditure plans and that the cash flow is planned, making sure that cash is available when needed. It is also key that when surplus cash is available this is invested with counterparties and in instruments commensurate with the Council's low risk appetite, whilst ensuring security and liquidity.

1.4 The Council's Investment Property Strategy is included within this document. This aims to provide a robust framework for the acquisition of property investments and the pursuance of redevelopment and regeneration opportunities.

Key implications

2 Comments of the Chief Finance Officer

2.1 The financial and risk implications are set out in detail within the attached Strategy and supporting Annexes.

3 Comments of the Head of Legal Services

3.1 There are no legal implications as a result of the recommendations in this report. The Council is required to approve a Capital, Investment and Treasury Management Strategy each financial year which includes an overview of Capital Financing, Treasury Management and Investments.

4 Equality

4.1 The proposals within this report do not have the potential to disadvantage or discriminate against different groups with protected characteristics in the community.

5 Climate change

5.1 There are no significant environmental/sustainability implications associated with the report. It is however recognised that some Council investments may be in companies that are considered to have a detrimental impact on the climate, for example oil companies.

Appendices

Appendix 1 – Capital, Investment and Treasury Management Strategy 2022/23 and supporting Annexes.

Background papers

Refer to 2022/23 Draft Budget and Medium Term Financial Strategy

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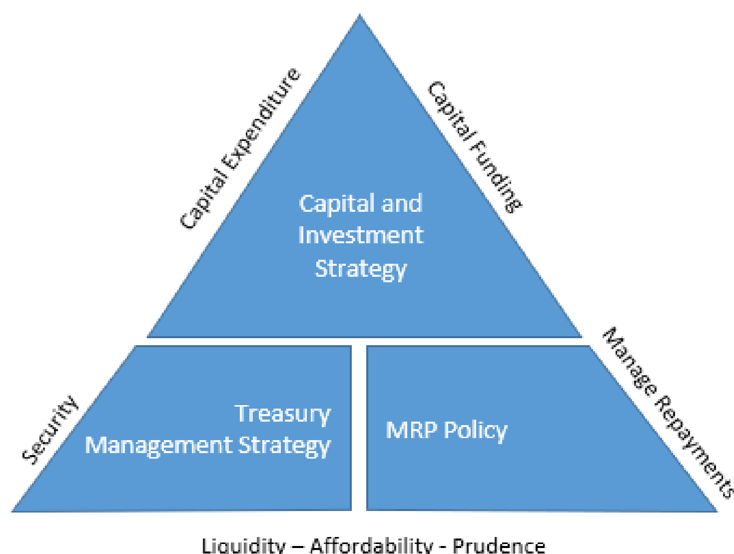
 APPENDIX 1

Capital, Investment and Treasury Management Strategy 2022/23

1. **Introduction**

1.1 The Capital, Investment and Treasury Management Strategy (the strategy) provides an overview of the three main components of capital planning;

- **Capital expenditure and investments**: the Capital Programme; supporting the Council's priorities included in the Strategic Plan and the Investment Property Strategy; generating income and supporting economic growth and regeneration;
- **Financing our capital plans, and maintaining liquidity**: the Treasury Management Strategy; setting out how the capital programme will be financed and how cash investments will be managed; and
- **Repaying our debt in a prudent way**: the Minimum Revenue Provision (MRP) Policy; setting out how we use the revenue budget to repay debt.



This report sets out a high-level overview of how capital expenditure, capital financing and treasury management activity contributes to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability.

1.2 The strategy sets out a clear picture of the plans of the Council for capital expenditure, and investment plans within the financial constraints, risk appetite and regulatory framework that the Council operates.

1.3 The strategy can be broken down into separate key elements that set out the Council's approach to capital, investment and treasury management:

- **Capital Overview** - asset management, capital expenditure planning, risk management and long-term sustainability of capital expenditure plans (**Section 2**)
- **Investment Overview** – setting out investment plans focusing on the approach to service and commercially led investment (**Section3**);
- **The Treasury Management Strategy Statement (TMSS)** – setting out how we borrow and invest to support our capital financing requirement (**Section 4**)
- **The Minimum Revenue Provision (MRP) Policy** – setting out how we repay capital borrowing (**Included as Appendix A**).

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

1.5 The strategy will:

- Set out how we ensure that capital expenditure contributes to the achievement of corporate priorities and the Strategic Plan;
- Explain how the Capital Programme is financed and demonstrates that it is affordable and sustainable;
- Explains the Council's approach to investments; and;
- Set out and fulfil the Council's regulatory requirements in respect of Borrowing, Treasury Management and Investment.

2 Capital Overview

Capital Expenditure and Financing:

2.1 The Council's intention in relation to capital investment is to ensure it can make a real and demonstrable impact on the economy of Tandridge by:

- **Regenerating the District**, by attracting and securing significant amounts of external investment to supplement Council resources and deliver an enhanced district-wide regeneration offer, and;
- **Prioritising the regeneration investment** to develop the local economy and to support job creation and promote local employment within the District.

2.2 The Council's capital expenditure and financing plans over the medium-term includes an overview of the governance arrangements for approval and monitoring of expenditure and, in relation to commercial investment activities, sets out the due diligence process and the Council's risk appetite in respect of these, including proportionality in respect of overall resources.

2.3 The section includes a projection of the Council's capital financing requirement and how this will be funded and repaid. It links to the Council's borrowing strategy and sets out the Council's statutory duty to make an annual revenue provision for the repayment of debt, detailed in the MRP Policy.

Capital Expenditure

2.4 Capital expenditure refers to Local Authority spending on assets such as infrastructure, property or vehicles that will be used for more than one year. In Local Government this includes spending on assets owned by other bodies and loans and grants to other bodies, enabling them to buy assets.

2.5 In the 2022/23 Budget and 3-year Capital Programme to 2024/25, the Council has a total capital expenditure requirement of £35.4m (2022/23 to 2024/25) as summarised in Table 1.

Table 1 - Estimates of Capital Expenditure

	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m	Total 2022/23 to 2024/25
General Fund services	3.7	9.8	1.8	1.2	1.3	4.3
Community Infrastructure Levy (CIL) Funded	0	1.0	2.6	0.5	0.0	3.1
Council Housing (HRA)	7.5	16.8	11.6	11.5	4.9	28.0
TOTAL	**11.2**	**27.6**	**16.0**	**13.2**	**6.2**	**35.4**

2.6 Our medium-term approach to financial planning means we can commit to a Capital Programme of c£35.4m over the next 3 years. The revenue implications of this proposed programme are integrated and factored into the financial planning over the Medium-Term Financial Strategy (MTFS) period.

2.7 In developing the capital expenditure estimates, we have ensured that borrowing costs remain in line with the revenue budget envelopes set out in the 2022/23 Budget and MTFS.

2.8 The main General Fund capital projects include vehicle replacement programme (£0.4m), Parks, Pavilions and Open spaces (£0.3m), Garden waste, recycling, food waste and refuse bins (£0.3m). The Council also has a total programme of £5.8m of capital expenditure on the refurbishment of Quadrant House as part of the Council's economic development plans. Quadrant House is currently a catalyst for improvement in Caterham and the expenditure is being funded via two Local Enterprise Partnership grants that have been awarded. In addition to Quadrant House the Council plans to incur £1.45m on the regeneration of Croydon Road streetscape, £0.95m of which is funded by CIL.

2.9 The Housing Revenue Account (HRA) is a ring-fenced account which ensures that Council Housing does not subsidise, or is itself subsidised, by other local services. HRA capital expenditure is therefore recorded separately.

2.10 The Council has specific arrangements for the management of capital expenditure to ensure they are aligned with the Council's priorities. The principles for governance of the capital programme are detailed in Appendix B. The separate approval process for the acquisition of investments in property is contained within the Investment Property Strategy (Appendix C).

2.11 Fundamentally, they are approved on the principles of value for money, affordability and deliverability. Projects need to demonstrate value for money and that they are capable of being delivered within expected timescales.

Capital Funding

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

Table 2 - Capital Financing

	2020/21 Actual £m	**2021/22 Estimate £m**	**2022/23 Estimate £m**	**2023/24 Estimate £m**	**2024/25 Estimate £m**	**Total 2022/23 to 2024/25 £m**
General Fund						
Grants & contributions	0.7	5.4	0.8	0.4	0.5	1.7
CIL	0	1.0	2.6	0.5	0	3.1
Internal resources	0.9	0.8	0	0	0	0
Borrowing	2.1	3.6	1.0	0.8	0.8	2.6
Total General Fund and CIL	**3.7**	**10.8**	**4.4**	**1.7**	**1.3**	**7.4**

HRA						
Grants & contributions	0.6	0	0	0	0	0
Internal resources	6.9	13.2	7.2	7.2	4.9	19.3
Borrowing	0	3.6	4.4	4.3	0	8.7
Total HRA	**2.3**	**16.8**	**11.6**	**11.5**	**4.9**	**28.0**
TOTAL	**7.5**	**27.6**	**16.0**	**13.2**	**6.2**	**35.4**

2.13 Borrowing is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as Minimum Revenue Provision (MRP).

2.14 Alternatively, proceeds from selling capital assets (known as capital receipts) may currently be used to replace debt finance. No use of receipts is currently assumed to repay existing debt.

2.15 Planned MRP is set out in the following table:

Table 3 - Repayment of Debt through Minimum Revenue Provision

	2020/21 Actual £m	**2021/22 Estimate £m**	**2022/23 Budget £m**	**2023/24 Budget £m**	**2024/25 Budget £m**
Minimum Revenue Provision	0.8	0.8	1.2	1.4	1.2

2.16 The Council's cumulative outstanding amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure on service delivery and on investments and reduces with MRP and capital receipts used to replace debt.

2.17 The CFR is expected to increase by £0.4m during 2022/23. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 4 - Prudential Indicator: Estimates of Capital Financing Requirement

	31/03/2021 Actual £m	31/03/2022 Estimate £m	31/03/2023 Estimate £m	31/03/2024 Estimate £m	31/03/2025 Estimate £m
General Fund services	25.4	28.3	28.3	27.9	27.8
Council housing (HRA)	61.3	64.9	69.3	73.6	73.6
Commercial activities/non-financial investments*	21.4	21.2	21.0	20.8	20.6
TOTAL CFR	**108.1**	**114.4**	**118.6**	**122.3**	**122.0**

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

2.18 Our capital plans lead to an increase in the estimated CFR of £7.6m over the three-year period. The revenue implications of this are set out below and the TMSS (Appendix D, section 6).

2.19 **Asset management and disposals:** The Council does not currently have a land disposal programme for the general fund. The current policy is to use any surplus land and property which is identified for housing purposes where feasible. If it is not feasible then a general fund capital receipts will be realised. When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. Repayment of capital grants, loans and investment also generate capital receipts. The Council is currently also permitted to spend capital receipts on service transformation projects which is expected to be extended by three years to 2025/26. In 2022/23 the Council plans to use c£0.4m of flexible capital receipts.

2.20 The Council plans to receive £2.5m of capital receipts in 2022/23 and the coming financial years as follows.

Table 5 - Capital Receipts Receivable

	2020/21 Actual £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m	2024/25 Estimate £m
HRA Disposals	2.5	1.8	1.8	1.8	1.8
GF Disposals*	0	0	0	0	0
Loans repaid	0.4	0.3	0.3	0.3	0.3
TOTAL	**2.9**	**2.5**	**2.5**	**2.5**	**2.5**

*to be prudent, the sale of Redstone House is not included in these projections until received

Revenue Budget Implications

2.21 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. This is referred to as net financing costs.

2.22 Current projections show that the net financing cost will be contained within budget projections over the MTFS, rising from £0.7m net in 2022/23 to £0.9m net in 2023/24 and then back down to £0.7m in 2024/25. The net costs of financing our capital plans are set out in the table below.

Table 6 – Net Finance Cost Budget

	2020/21 Actual £m	**2021/22 Estimate £m**	**2022/23 Estimate £m**	**2023/24 Estimate £m**	**2024/25 Estimate £m**
MRP	0.8	0.8	1.2	1.4	1.2
Interest Payable (GF)	1.1	1.1	1.1	1.1	1.1
Investment Interest	(1.6)	(1.6)	(1.6)	(1.6)	(1.6)
Net Finance Cost	**0.3**	**0.3**	**0.7**	**0.9**	**0.7**

2.23 The proportion of net finance cost to net revenue budget is a key indicator of direction of travel relative to medium term revenue resources and provides insight into the affordability of finance costs (see TMSS Appendix D, Annex 1, Table 2).

Financial Sustainability

2.24 Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred over the MTFS will extend for up to 50 years into the future. The Chief Finance Officer (Section 151 Officer) is satisfied that the proposed Capital Programme is prudent, affordable and sustainable because it remains proportional to the Council's overall revenue budget.

3 Investment Overview

3.1 In addition to service-led capital expenditure, the Council has invested its money for a further two broad purposes:

- To support local public services by setting up, lending to or buying shares in other organisations (service investments);
- As a result of surplus cash from its day-to day activities, for example when income is received in advance of expenditure (known as treasury management investments)

Service Investments: Loans

3.2 **Overview:** The Council invests money in its subsidiary, Gryllus Property Limited and other organisations to support local public services and stimulate local economic growth, for example Freedom Leisure.

3.3 **Security:** The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk and ensure that total exposure to service loans remains prudent, decisions on service loans are made in the context of their value, the stability of the counterparty and an assessment of the risk of default. The current value of service loans is set out as follows:

Table 7 - Loans for service purposes

Category of borrower	**31.3.2021 actual**		
	Balance owing	**Loss allowance**	**Net figure in accounts**
Subsidiaries	15.1	0	15.1
Suppliers	1.3	0.1	1.2
TOTAL	**16.4**	**0.1**	**16.3**

3.4 Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's Statement of Accounts are shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum advanced and has appropriate credit control arrangements in place to recover overdue repayments. In the case of our service loans, these allowances are £0.1m.

3.5 **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding service loans by reference to their financial position, past experience and other factors. We wholly own our subsidiaries for service purposes and so their financial position is subject to the same rigour and control as that of the Council.

Service Investments: Shares

3.6 **Security**: One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. To limit this risk, upper limits on the sum invested in each category of shares have been set as follows:

Table 8 – Shares held for service purposes

Category of company	31.3.2021 actual		
	Amounts invested £m	Gains or losses £m	Value in accounts £m
Subsidiaries	5.3	0	5.3
TOTAL	**5.3**	**0**	**5.3**

3.7 **Risk Assessment:** The investment in shares totalling £5.3m is within the Council's subsidiary Gryllus Property Limited. The Authority assesses the risk of loss before entering into and whilst holding shares by assessing the current and future return achievable and the level of security provided by the assets of the company, and the level of control which the Council can exert over the strategy of the company. The Council has created an Income Equalisation Reserve, with a current balance of c£0.4m to finance any diminution in value and income volatility. The Income Equalisations Reserves will help mitigate the risk of any loss of income from the Council's investments allowing time to formulate plans to address any longer-term reductions in income.

3.8 **Liquidity:** The funding of long term investments in the Council's subsidiary are financed by fixed long term borrowing, so that there is no short or medium tern risk to the liquidity of the Council, which would require the Council to be forced to liquidate its assets in the company.

3.9 **Non-specified Investments:** Shares are the only investment type that the Authority has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Authority's upper limits on non-specified investments. The Authority has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

3.10 **Governance:** Decisions on service investments are agreed by Executive Leadership Team, led by the Chief Executive in consultation with the Chief Finance Officer and must meet the criteria and limits laid down in the Investment Property Strategy. Most loans and shares are capital expenditure and purchase will therefore also be approved by Members as part of the capital programme.

Property Investments

3.11 **Overview:** The Council holds investments in local commercial property; office space and leisure, with the intention of supporting Tandridge's economy and generating a surplus that will be spent on local public services. The table below shows the value of our investments by main category, including those under construction where the ultimate use is to be determined.

Table 9 – General Fund Property held for socio economic and/or development purposes

Property Type	Actual	31/03/2021 Actual	
	Purchase cost £m	Gains or (losses) £m	Value in accounts £m
Offices	20.0	(0.6)	19.4
Leisure	0.9	-	0.9
TOTAL	**20.9**	**(0.6)**	**20.3**

3.12 **Security:** In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

3.13 A fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. The Council holds these properties for socio economic and/or development purposes, short-term fluctuation in investment values can be expected. Should the 2022/23 year-end Accounts preparation and audit process value these properties below their purchase cost, we will take mitigating actions to protect the capital invested, such as exploring alternate uses where appropriate.

Proportionality

3.14 The Council's revenue budget includes an element of profit generating investment activity to support services. The table below shows the extent to which the expenditure planned to meet the service delivery objectives and/or place making role of the Council is dependent on achieving the expected net profit from investments over the lifecycle of the MTFS. Investment activity is forecast to remain at approximately 6-8% of the Council's net revenue stream over the medium-term. Should we fail to achieve the expected net profit, the Council would manage the impact on budget through use of contingency in the current financial year and a re-assessment of efficiency plans for the remainder of the medium-term.

Table 10: Proportionality of Investments

	2022/23 Estimate £m	2023/24 Estimate £m
Net Revenue Stream	11.4	11.0
Investment rental income	0.7	0.9
Proportion	6%	8%

The medium-term financial strategy for revenue extends to 2023/24

4. Treasury Management Strategy Statement 2022/23

4.1 The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet service activity. This involves both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities.

4.2 **Prudential Code Consultation**: the recent CIPFA consultation suggests that authorities who have an expected need to borrow should review options for exiting their existing financial investments. As long as the pros and cons of retention have been considered before borrowing externally for further capital expenditure then existing financial investments can be retained and expenditure on repair, renewals and refurbishments can also be incurred.

4.3 The Council's Treasury Management Strategy Statement and associated annexes can be found at Appendix D.

APPENDIX A

Annual Minimum Revenue Provision (MRP) Policy Statement 2022/23

Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum previous to 2017/18. The Local Government Act 2003 requires the Council to have regard guidance issued by the Department for Levelling Up, Housing and Communities Guidance on Minimum Revenue Provision.

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

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

The Council's MRP policy will be Asset Life Method. This basis is subject to review and changes in line with the Councils Treasury Management Strategy and approved Prudential Indicators which are revised annually.

Capital expenditure incurred during 2022/23 will be fully subject to a MRP charge from 2024/25 onwards or in the financial year after the asset becomes operational whichever is the latest. This ensures that MRP is only charged to the first, full operational year of the asset's life.

The Council is recommended to approve the following MRP Policy Statement:-

For **all** unsupported borrowing (General Fund) the MRP Policy will be; Asset Life – Annuity Method, in order to better match MRP to the period of time that the assets are expected to generate a benefit to the Council. (The previous MRP Policy method was Asset Life – Straight Line Method for internal borrowing). Moving from straight line to annuity makes for a more even spread of costs over the life of the assets since interest costs (or investment income foregone) will be higher at the start of the loan and lower at the end. Repaying principal on a straight-line basis therefore unnecessarily front-loads the overall cost.

There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made.

APPENDIX B

CORPORATE GOVERNANCE

Executive Leadership Team

Executive Leadership Team (ELT), which comprises the Executive Heads of each Department lead by the Chief Executive, is the officer body for Capital Investment development and planning and is charged with bringing forward funded capital expenditure plans for approval by the Strategy and Resources Committee. The Committee considers capital expenditure and funding plans, monitors performance through a series of regular capital monitoring reports and recommends the annual Capital Programme to Council for approval.

All capital investment will be commissioned on the recommendation of the ELT which will enable any expenditure and it's funding to be aligned with the Council's Key Capital Priorities and funding sources. Partners, from both the public and private sector will be at regional and local levels as well as at a District level.

Approval of Capital Investment

Within the Council, a concept for a potential capital project will originate from, or at least be 'owned' by the Executive Head. The 'owner' should prepare or direct the preparation of a Strategic Business Case (SBC) for the proposed project. The Strategic Business Case outlining the initial idea or 'concept' for a project should be submitted to ELT for consideration.

If ELT is satisfied that the proposal meets investment criteria, it will be given approval to progress to Stage 2 of the process – the completion of an Outline Business Case (OBC).

The OBC builds on the SBC providing more detailed information including the benefits that could be realised focusing on the links to the Council's Capital Investment Priorities and the proposed outcomes and may include several options to deliver the proposed benefits. The OBC will be submitted to the ELT for consideration, and if it is satisfied with the proposal will give guidance for the development of a preferred option.

Stage 3 of the process entails the completion of a Final Business Case (FBC) which will then be submitted to the ELT for final consideration. Again, building on the OBC, the FBC will contain evidence of a:

- Full option appraisal;
- Detailed financial analysis of all costs/income including how the project is financially sustainable and that any adverse revenue implications can be dealt with within existing budgets;
- Robust delivery plan including how the chosen option delivers the highest impact in achieving the required outcomes with identified key project milestones enabling progress review. Included within the delivery plan should be proposed consultation arrangements, value for money assessment equality and environmental impact assessments;
- Risk assessment and that appropriate actions to negate these risks have been identified;
- Full exit strategy where the project involves a disposal; and
- Method of procurement that represents value for money.

Depending on the circumstances of the bid for resources, ELT has the discretion to vary the three-stage review process and omit one or more of the stages. Once Final Business Cases have been agreed, these bids will be prioritised against agreed criteria

The results of this process will be presented to Members for approval each year as part of the capital budget setting process, or during the year if projects come forward outside the normal timeframe.

Service Challenge & Review, Efficient Use of Assets

With regard to the review of operational assets, the Asset Management Team and services continue to work closely with service managers alongside wider public and third sector partners to ensure that portfolios are best fit for purpose and efficient usage is maximised.

The Chief Executive and ELT will oversee any acquisition and disposal of land and property assets and monitors the progress of any corporate disposals and performance of the investment portfolio.

In terms of acquisition of property there is a specific process for this under Financial Regulation 17 to enable proposals to progress in year. Details of this are set out in the Investment Property Strategy.

Performance Monitoring of Capital Programme

The capital expenditure investment approach above is supported by a strong programme management process to ensure a coordinated corporate approach. This will ensure that investments are planned, managed and delivered prudently.

ELT has a remit to review the financial performance of the capital programme and it receives a monthly monitoring report. In addition, financial monitoring reports will be considered by Service Committees periodically throughout the year, together with a capital outturn report. Issues that have been considered and agreed at ELT can be reported to Service Committees as necessary via the regular financial monitoring reports.

The undertaking of the detailed annual review of the capital programme provides the opportunity to review all schemes or focus on specific areas of concern.

Where a potential cost overrun has been identified, ELT will explore possible solutions in detail. It will also consider any underspending or identified surplus resources which can be added to the central pool of resources. ELT may also suggest a reallocation of resources to other projects.

Where there is a delay in the commitment of programme/project resources, the ELT will require project managers to report the reasons for the delay and consider whether it would be appropriate to recommend the decommissioning of the project and the reallocation of un-ring-fenced resources to other projects.

APPENDIX C

INVESTMENT PROPERTY STRATEGY 2022/2023

Introduction

1. The Investment Property Strategy forms part of the Council's overall Capital Investment & Treasury Management Strategy and is included with the fund performance monitoring and reporting procedures.

2. The returns from property investment will contribute positively towards the achievement of savings targets and budgets to enable the continued delivery and investment in key frontline services and/or the bolstering of financial reserves whilst achieving a balanced budget.

3. The Investment Property Strategy aims to provide a robust and viable framework for the acquisition of property towards the pursuance of redevelopment and regeneration opportunities that can deliver positive returns and significant benefits to our residents, businesses and communities.

4. The strategy is to set out how the Investment Property Portfolio will be managed and covers the following matters:

    - Objectives and strategic priorities for Investment Property;
    - Governance and performance reporting arrangements;
    - Risks;
    - Portfolio Mix;
    - Funding, Performance monitoring and Financial Indicators for Investment; Property
    - Investment evaluation criteria;
    - Acquisition procedure; and
    - Disposal Procedure

Background

5. The Local Government Act 2003 (the Act) and supporting regulations requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and MHCLG Investment Guidance (the Guidance) to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

6. The Local Government Act 1972 – Section 120 of the Local Government Act 1972 empowers local authorities to acquire by agreement "any land whether situated inside or outside their area for the purpose of any of their functions under this or any other enactment, or for the benefit, improvement or development of their area".

7. The Localism Act 2011 – Part 1, Section 1 of the Localism Act 2011. Local Authorities are allowed to confer powers for a commercial purpose or for the benefit of the Authority, its area or residents.

Government Guidance

8. In February 2018 the Secretary of State issued new guidance on Local Government Investments (the Guidance) which widened the definition of an investment to include all the financial assets of a Local Authority as well as non-financial assets held primarily or partially to generate a profit.

9. The Guidance requires the Investment Property Strategy to be approved by Full Council on an annual basis and sets out the disclosure and reporting requirements. Any midyear material changes will also be subject to Full Council approval. Further CIPFA guidance issued in November 2019 reinforces the need for a comprehensive Investment Property Strategy.

10. In November 2020 HM Treasury published their conclusions from the consultation regarding the use of monies lent by the Public Works Loan Board (PWLB). "In recent years a minority of local authorities have borrowed substantial sums from the PWLB to buy investment property with the primary aim of generating yield".

11. New guidelines have been brought in for PWLB borrowing which mean that borrowing for yield purposes only will not be possible without using other sources of finance, which would almost certainly mean increased costs for the Council. Borrowing for yield through the PWLB will exclude the Council from all other future PWLB borrowing whatever the purpose. This would cause significant problems and increase costs, in particular for the funding of affordable housing development and essential works through the Housing Revenue Account. Other sources of finance are unlikely to be at such competitive levels.

12. *The latest draft of the Prudential Code was released in late 2021. The main elements of the Code in relation to commercial property are as follows. The Prudential Code determines that certain acts or practices are not prudent activity for a Local Authority and incur risk to the affordability of Local Authority investment. An authority must not borrow to invest primary for financial return;*

    - *It is not prudent for Local Authorities to make any investment or spending decision that will increase the CFR, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority and where any financial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose.*

    - *The UK Government's rules for access to PWLB lending at the date of this publication require statutory Chief Finance Officers to certify that their Local Authority's capital spending plans do not include the acquisition of assets primarily for yield, reflecting a view that Local Authority borrowing papers are granted to finance direct investment in local service delivery (including housing, regeneration and local infrastructure) and for cash flow management, rather than to add debt leverage to return-seeking investment activity.*

Since access to the PWLB is important to ensure Local Authorities' liquidity in the long term, and leveraged investment always increases downside risks, local authorities must not borrow to fund acquisitions where obtaining financial returns is the primary aim. Authorities with existing commercial investments (including property) are not required by this Code to immediately sell these investments. However, Authorities which have an expected need to borrow should review options for exiting financial investments for commercial purposes in their annual treasury management or investment strategies. The options should include using the sale proceeds to repay debt or reduce new borrowing requirements. They should not take new borrowing if financial investments for commercial purposes can reasonably be realised instead, based on a financial appraisal which takes account of financial implications and risk reduction benefits. Authorities with commercial property may also invest in the repair, renewal and update of their existing commercial properties.

Objectives and Strategic priorities for the Property Investment Portfolio

13. The objective of the Investment Property Strategy is to establish a framework for the identification of property investments which, if acquired, would either provide the Council with a positive rental return and capital growth or provide significant regeneration and/or development opportunities for the District. When making Investments the Strategy & Resources Committee will have regard not only to the potential for positive rental returns and capital growth but also to the likely economic, social and environmental benefits for the residents and businesses of the Council.

14. The Council considered the potential outcome of the HM Treasury consultation through 2020. Mindful of the economic climate, organisational attitude to risk and the Council's financial position it anticipated the outcome of the Consultation and moved away from acquisitions of commercial property for yield.

15. The Investment Evaluation Criteria (Annexe A) and the Acquisition and Disposal Procedure (Annexe B) remain applicable as they cover good practice of all property purchase circumstances.

16. In delivering the strategy over the next year the following main priorities are to be used to guide the growth of the investment property portfolio:

    a) A major driver for acquisition of new investment property will be economic benefit for the residents of the Council either through protection of commercial space or employment generation/protection.
    b) Properties that have a development potential will also be considered for their long-term benefits.

    Investments will be mainly focussed within the District boundary. It is not considered that there will many opportunities for properties outside the District over the next three years of the Strategy which will align with the Council's priorities

17. Investment relating to the Strategy will be directed towards:-

Regeneration and Development Opportunities

Investment which can facilitate/generate regeneration or economic development benefits as well as positive financial returns for the Council. Financial returns for the Council may come in the form of increased business rates or New Homes Bonus where the Investment is within the District.

The Contributions from Regeneration and Development Investments will include positive financial returns for the Council and may also include the following:

- Regeneration benefits for the area including employment opportunities;
- Economic benefits for the area;
- Social value improvements e.g. place-making, public realm space, pride in one's local area and surroundings; and
- Environmental improvements e.g. demolition or refurbishment of old, inefficient and/or vacant/unsightly properties.

Economic, social and environmental benefits collectively make up the strategic value of an asset, and collectively, they can drive inward private investment and prosperity for an area.

Governance and Performance

18. The Strategy and Resources Committee will be responsible for approving the strategic priorities and the arrangements set out in this policy. There will be an annual report to the Committee that will set out performance over the previous year and plans for the next.

19. Operational management, including acquisitions is to be delegated to officers acting within Financial Regulation 17 of the Council Constitution

    a) The Chief Executive in consultation with Members as per Standing Order 46 of the Council's Constitution (Part B)[1], has delegated authority for acquisitions up to £10m
    b) The Committee process will be used for acquisitions above £10m

20. The Council recognises that investing in land and properties is a specialist and potentially complex area. The Council will require the services of professional property, legal and financial advisers, where appropriate, in order to access specialist skills and resources to inform the decision-making process associated with the strategy.

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[1] Standing Order 46 prescribes that :(i) I the Council is in a state of no overall control (i.e. where no single political group or coalition of groups has an absolute majority of seats) such consultation shall be with the Leaders, or their nominated representatives, of political groups comprising ten or more Councillors; or (ii) if a single political group or a coalition of groups forming the Administration has an absolute majority of seats, such consultation shall be solely with the leader(s) of the Council or his / her / their nominated representative (s).

21. The Executive Head of Communities shall lead on potential purchases and development opportunities that meet the pre-determined selection criteria contained within the strategy. The criteria to evaluate potential acquisitions is attached as **Annexe A**. The Asset Management team will identify opportunities based on the selection criteria, will co-ordinate all necessary due diligence in accordance with the Acquisition Procedure (**Annexe B**), and will present a business case for challenge and scrutiny to the relevant Committee or Chief Executive as required under Financial Regulation 17.

22. CIPFA Guidance requires that elected members and officers involved in the investment decision-making process have appropriate capacity, skills and information to enable them to take informed decisions as to whether to enter into a specific investment. In addition, it places a duty on the council to ensure that advisors negotiating deals on behalf of the Council are aware of the core principles of the prudential framework and the regulatory regime in which the Council operates.

23. The Council recognises that it is responsible for property investment decisions at all times and will ensure that undue reliance is not placed upon our external service providers.

24. The Executive Head of Communities is to be accountable for the performance of the Investment Property Portfolio and will be charged with making recommendations to the Chief Executive for acquisitions.

25. Disposal of Investment Property assets are to be undertaken in accordance with the Council's Financial Regulations and delegated Authorities. The Executive Head of Communities will make recommendations to the Strategy & Resources Committee and in accordance with officer delegated powers.

26. The Strategy and Resources Committee delegates the Freehold Disposal of assets in the General Fund worth less than £250,000 to the Chief Executive in consultation with Members as per Standing Order 46 of the Council's Constitution (Part B)[2]. Leasehold disposals of General Fund assets of up to 16 years and with an annual rental valuation of up to £75,000 are also delegated to the Chief Executive, in consultation with Members as per Standing Order 46 of the Council's Constitution (Part B)[3].

[2] As per footnote 1 on the previous page
[3] AS per footnote 1 on the previous page

Risk Assessment

27. Property investment has its own specific risks, set out below:

   a) **Property Risks** – the property market is cyclical and is affected by the wider economic environment. There are also property risks that are specific to a building due to its location, condition and quality of the tenants. Mitigation proposed in this policy for these risks include diversifying the portfolio (portfolio mix) to include investments that perform during different cycles of the economic cycle. The evaluation criteria, diversity of location, due diligence tests, approval processes and accountability for implementation are also proposed to address property specific risks;

   b) **Financial Risks** – the primary financial risks are borrowing levels, interest rate movement, ongoing ability to service debts, the general investment market conditions and its effect on rental income. Proposals have included the creation of a fully owned subsidiary property investment company, Gryllus Property Ltd and a funding strategy that allocates debt and all associated costs to the investment property portfolio so that the net revenue benefits to the Council is transparent and can be benchmarked; and

   c) **Corporate Risks** – effective delivery of the Strategy requires staff with the requisite expertise, effective arrangements for asset management and the recognition of the reputational risks that can come from inappropriate tenants and from legal and environmental breaches. In accordance with the Statement of Investment beliefs as we are investing public money we will be sensitive to the ethical considerations of local residents.

28. The Council assesses the risk of loss before entering into and whilst holding property. The approach is laid out in **Annexe A** – Investment Evaluation Criteria.

Liquidity

29. Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. The funding of long-term investments is financed by fixed long term borrowing, so that there is no short or medium-term risk to the liquidity of the Council, which would require the Council to be forced to liquidate its asset and suffer a loss nor impact upon the Council's provision of services. As these long-term investments are matched by long term borrowing, it will not be necessary to access the invested funds in an emergency. Investments in property are not undertaken unless they are secure over the medium term, have additional socio- economic benefits and the target rate of return significantly exceeds the annual cost of borrowing.

Portfolio Mix

30. The medium and long term aims of the Strategy have been adjusted following the publication of the HM Treasury consultation to:

   a) Acquire properties within the District in areas with strong sustainable economic activity i.e. areas with the environmental and business activities capable of providing an economy whereby capital and rental growth over the mid to long term was possible;
   b) When making investments the Strategy and Resources Committee will have regard to other economic and social benefits for the residents of Tandridge; and
   c) Achieve a balanced portfolio where after 6 (was 4) years[4] no single class of property, ie retail, industrial, office and leisure is larger than 60% and none smaller than 10%, other than retail or leisure.

Contribution

31. The Council has previously invested in commercial property with the intention of making a surplus that will be spent on local services and for socio- economic benefits. The portfolio is at an early stage of development.

32. Table 1 shows the properties currently held by Tandridge District Council for Investment Purposes, by type

Property by Type	Value in Accounts 31st March 2020	Value in Draft Accounts 31st March 2021
Offices & Mixed/other	£20,591,000	£19,441,000
Leisure	£936,000	£909,000
Total	**£21,527,000**	**£20,350,000**

*Values taken from external annual valuations by Wilkes, Head & Eve

33. Investments held under Gryllus Holdings are reported separately.

34. Gross & Net Income from Investment Property

	31st March 2021	31st March 2022 (forecast)
Gross Income	Not reported	£919,910
Net Income	£746,000	£608,494

Funding and Financial Performance of the portfolio

35. The Council will fund investment property acquisitions by utilising the most appropriate and efficient funding strategy available at the time of purchase. The Council has the option of utilising long term prudential borrowing, capital receipts or reserves. Financing decisions will link to the Council's Capital & Investment Strategy and Treasury Management Strategy.

[4] Change made in 2020/21 Investment Property Strategy

36. All new acquisitions are to achieve an appropriate positive return net of borrowing and other costs associated with the acquisition. Properties purchased for redevelopment, refurbishment or regeneration may not provide an immediate positive return. These will be assessed through a business case and considered by Strategy & Resources Committee

37. Separate accounts are to be kept for income and expenditure in connection with investment property and are to be included in the annual report to the Strategy & Resources Committee.

38. Key Indicators have been adopted to monitor performance of the portfolio. Performance will be reported against the following indicators along with a property market narrative:

- **Total Return** – the annual increase in capital value plus income expressed as a percentage of the previous year's capital value (adjusted to include purchases);
- **Effective Return** – total return receivable less costs expressed as a percentage of the previous year's capital value;
- **Growth in Asset Value** – Percentage increase per year;
- **Income Growth** – Percentage increase in gross income per year; and
- **Vacancy Rate** – Expressed as a percentage and number of vacant units compared with total number of units. This will also be expressed in terms of lost rental. Void periods are factored into financial appraisals as part of the assessment criteria.

	2019/20	2020/21
A) Total Return	6.42%	-0.017%
B) Effective Return	3.31%	-0.02%
C) Growth in Asset Value	281%	-0.05%
D) Income Growth	407%	0%
E) Vacancy Rate	No vacant buildings. Quadrant House is 33% vacant	Redstone House is vacant pending sale. Quadrant House remains 33% vacant by floor area

39. In addition to property specific performance indicators are quantitative indicators that will be reported within the Council's Capital & Investment Strategy and Treasury Management Strategy to allow Councillors and the Public to assess a local authority's total risk exposure as a result of property investment decisions.

40. The operating cost of the Council's internal Strategic Asset Management Team excluding the Housing Development Specialists is projected to be £134,965.40 for the year 2021/22. (£144,766 - 2020/21). The costs reflect the cost of managing the Council's entire property portfolio and *functions*, not just the assets acquired under this Property Investment Strategy. Additional costs may be incurred as a result of the purchase of Investment Properties. Any such costs will be factored into the financial appraisals as part of the purchase assessment to ensure that anticipated net rates of return are achieved.

Investment Property Strategy – Annexe A

Investment Evaluation Criteria

41. As with other forms of investment at the most basic level, property investment is a trade-off between risk and return. A traditional well diversified property portfolio (spread across different property sectors and geographical areas) will deliver long-term rental and capital growth with relatively low risk.

42. Prime property in the target region covered by this strategy will typically provide an initial yield of between 5 –7% with the additional prospect of capital growth leading to a higher total return to the Council. Equivalent /Income yields over longer periods will also be reported.

43. The four main commercial property sectors will be included (industrial, office, retail and leisure) and in turn, these will be additionally diversified on criteria including location, the lease term and lot size. This will assist in protecting the Council's overall risk return profile should an individual property investment cease to be income producing (for example, it is undergoing refurbishment or awaiting a new tenant). Residential and mixed used sites will be considered using similar criteria albeit for residential investments lease terms and repairing obligations are likely to be very different. Regeneration opportunities and potential development sites will be considered using additional criteria, including if a development appraisal shows strong potential or if there is strong asset management potential.

44. The following Criteria are to be used to make decisions on acquiring new property investment properties:

    a. **Location** – Property is categorised as prime, secondary or tertiary in terms of its location desirability. For example, a shop located in the best trading position in the town would be prime, where as a unit on a peripheral neighbourhood shopping parade would be considered tertiary;
    b. **Tenant covenant** – the financial strength of a tenant determines the security of the property is rental income. A financially weak tenant increases the likelihood that the property will fall vacant. The minimum acceptable financial strength for any given tenant will be determined through financial appraisal of company accounts and the use of appropriate methods of risk assessment and credit scoring. To minimise management and risk, the preference will be for single occupancy investments wherever possible;
    c. **Lease terms** – the lease is to be free from unencumbered/onerous terms. The lease must have mechanisms for the rent to be periodically reviewed to take into account inflation and upward market movement;
    d. **Occupational lease length** – the lease term will determine the duration of the tenant's contractual obligation to pay rent. The most attractive investments offer a long lease with a strong tenant covenant. The lease term will reflect any tenant break clause;
    e. **Building quality** – a brand-new or recently refurbished building will not usually require capital expenditure for at least 15 years. This is attractive for income investors requiring long-term rental income with a minimum of ongoing capital expenditure;

f. **Tenure and Title** anything less than a freehold acquisition will need to be appropriately reflected in the price. The legal title is required to be clean and free from any onerous conditions;
g. **Tenant repairing obligations**. – Under a full repairing and insuring lease (FRI), the tenant is responsible for the building's interior and exterior maintenance/repair. The obligation is limited to the building's interior under an internal repairing and insuring lease (IRI). The preference will be to favour FRI terms (or FRI by way of service charge i.e. all costs relating to occupation repairs are born by the tenants administered through a service charge; and
h. **Lot size** – to maintain portfolio balance the preference will be for no single property to exceed £25 million for a single let property.

In addition, it must -

a. Have passed a **building and plant survey;**
b. Show a **positive return** after making allowance for financing costs, borrowing repayments and other associated costs;
c. Be supported by an Independent **RICS Red Book Valuation;** and
d. Be accompanied by a **full business case report** prepared by the Executive Head of Communities and other officers where relevant.

Each potential property investment will undergo a quantitative and qualitative appraisal and risk assessment to establish portfolio suitability and the legal and financial implications of the purchase.

All due diligence findings will be included in the reporting procedure. The business case is to include reference to all areas above, the financial modelling, a risk assessment matrix and Strengths, Weaknesses, Opportunities and Threats (SWOT) analysis.

An investment opportunity that does not meet the minimum criteria and investment criteria may have separate investment or regeneration benefits and therefore may be considered separately under the regeneration and development stream of the strategy.

For a regeneration or development opportunity to be considered by the Council it must:

a. Deliver a rate of return commensurate with the deemed level of risk associated with the investment. The financial returns from regeneration activities may be capital rather than revenue. If the returns are capital all the full costs will be capitalised; and
b. Be accompanied by a full business case prepared by the Executive Head of Communities and other officers where relevant.

45. Some of the above criteria may be relaxed if the property is of strategic value to the Council and has gained Strategy & Resources Committee Approval. Strategic Value may be seen where a property is close to significant Council land ownership, a property gives economic benefits through Council ownership and or there are opportunities to change the use in accordance with Council priorities.

Investment Property Strategy - Annexe B

Acquisition Procedure

46. Acquisition of new investment properties is to follow the following process:

Activity	Acquisition Stage and Timeline Guide
a) Property identified as a potential investment by Asset Management or by Agents b) Property to be discussed with in house Legal team for initial review c) Executive Head of Communities to notify Chief Executive and the Investment Property Group (includes Head of Legal & Head of Finance) of potentially suitable property and summarise to seek views d) If possible, obtain desktop valuation from suitably qualified and experienced Valuer e) Review the valuation against the cost of Borrowing with Finance f) Finance to undertake search of tenant to ascertain the tenant's current financial status g) Finance to produce initial financial appraisal	Initial Review 2 to 3 weeks
h) Make offer for property, subject where appropriate to any of the following: • Contract • Approval by Chief Executive, or relevant Committee • RICS Red Book valuation carried out by external Registered Valuer (independent of introducing Agent) • Searches • Legal due diligence to include receipt and analysis of all leases to determine landlord's financial obligations • Disclosure of freehold title and review to ensure clear of any onerous restrictions. • Pre-acquisition survey by chartered building surveyor to include, if appropriate, structural, mechanical and electrical survey • Internal inspection • Valid Energy Performance Certificate • Disability Discrimination Assessment if appropriate • Environmental desktop study if search suggests one is appropriate • Asbestos Survey if appropriate • Resolution of any TUPE transfer implications	Under Offer 3 to 4 weeks

• VAT • Insurance requirements • Tax implications If offer accepted: i) Instruct legal services to deal with contract documentation, searches and legal due diligence j) Instruct valuation k) Instruct surveys l) If appropriate based on any of the above, propose adjustment to purchase price to reflect the monetary value of any issues discovered.	
m) Complete any outstanding surveys/ M&E reports and resolve all contractual matters before exchange n) Complete TDC Strategic Asset Management Acquisition Checklist o) Complete full Business Case for approval in accordance with Financial Regulation 17. p) Following agreement of terms and before instructing exchange of contract prepare Record of Officer Delegated Decision Notice and advise Leader of the Opposition and Ward Councillors if located in the District prior to publication date q) Arrange for transfer of funds r) Arrange Insurance Cover s) Exchange Contracts, if not simultaneous with Completion	Exchange 1-2 weeks
t) Complete purchase. All Documents and Management handed over to Asset Management to take forward as appropriate.	Completion 1 day

47. Newly purchased property acquired under this strategy would be added to the existing portfolio. The Asset Management Team would undertake management to maintain and improve the performance of an investment property; or additional specialist resources may need to be brought in as required.

Disposal Procedure

48. Properties will be considered for sale based on their performance and fit for the portfolio.

49. Any property considered for sale should be appropriately marketed. If an off-market approach is made and considered the property would not be sold unless the price offered is in excess of an independent Red Book Valuation to support such a decision

50. A property will be disposed of in accordance with the Financial Regulations of the Council's Constitution and in line with the Delegated Authority provisions in place. The Executive Head of Communities will make recommendations to the Strategy & Resources Committee and in accordance with officer delegated powers.

APPENDIX D

Treasury Management Strategy Statement 2022/23

1. **Introduction**

1.1 Treasury management at Tandridge District Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

1.2 In addition, the Department for Levelling Up, Housing and Communities (DLUHC) issued revised Statutory Guidance on Local Government Investment in February 2018.

1.3 This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code. Prudential Indicators and Treasury Indicators are set out in Annex 1 and a number of treasury limits and indicators are set out below.

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

1.5 The Council is typically cash rich in the short-term as revenue income is received before it is spent, but will have less cash in the long-term as capital expenditure is incurred before being financed. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account.

1.6 The Treasury Management Strategy is supported by four annexes:

- Prudential indicators – a Code requirement which supports our approach to borrowing, managing risk and highlighting our capital financing requirement.
- Detailed external context – a detailed summary from Link Group of the current and future economic climate, risks and opportunities along with detailed interest rate forecasts.
- Investment & Debt Portfolio Position as at 31 March 2021 – to highlight the range of debt and investments from the prior year audited accounts.
- Glossary of Terms

2. External Context

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 20th December 2021. These are forecasts for certainty rates, gilt yields plus 80 bps.

Link Group Interest Rate View	20.12.21													
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30

Additional notes by Link on this forecast table: -

- *LIBOR and LIBID rates will cease from the end of 2021. Work is currently progressing to replace LIBOR with a rate based on SONIA (Sterling Overnight Index Average). In the meantime, our forecasts are based on expected average earnings by local authorities for 3 to 12 months.*
- *Our forecasts for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short term cash at any one point in time.*

2.1 Over the last two years, the coronavirus outbreak has done huge economic damage to the UK and to economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it left Bank Rate unchanged at its subsequent meetings until raising it to 0.25% at its meeting on 16th December 2021

2.2 As shown in the forecast table above, the forecast for Bank Rate now includes four increases, one in December 2021 to 0.25%, then quarter 2 of 2022 to 0.50%, quarter 1 of 2023 to 0.75%, quarter 1 of 2024 to 1.00% and, finally, one in quarter 1 of 2025 to 1.25%.

2.3 Significant risks to the forecasts

- **Mutations** of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, or cannot be administered fast enough to prevent further lockdowns. 25% of the population not being vaccinated is also a significant risk to the NHS being overwhelmed and lockdowns being the only remaining option.
- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity.
- **The Monetary Policy Committee** acts 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.

- **The Monetary Policy Committee** tightens monetary policy too late to ward off building inflationary pressures.

- **The Government** acts too quickly to cut expenditure to balance the national budget.

- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

- **Longer term US treasury yields** rise strongly and pull gilt yields up higher than forecast.

- **Major stock markets** e.g., in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the "moral hazard" risks of having to buy shares and corporate bonds to reduce the impact of major financial market selloffs on the general economy.

- **Geopolitical risks,** for example in Ukraine, Iran, North Korea, but also in Europe and Middle Eastern countries; on-going global power influence struggles between Russia/China/US. These could lead to increasing safe-haven flows.

The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is now to the downside, including risks from Covid and its variants - both domestically and their potential effects worldwide.

2.4 Forecasts for Bank Rate

It is not expected that Bank Rate will go up fast after the initial rate rise as the supply potential of the economy is not likely to have taken a major hit during the pandemic: it should, therefore, be able to cope well with meeting demand after supply shortages subside over the next year, without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the spike up to around 5%. The forecast includes four increases in Bank Rate over the three-year forecast period to March 2025, ending at 1.25%. However, it is likely that these forecasts will need changing within a relatively short timeframe for the following reasons: -

- We do not know how severe an impact Omicron could have on the economy and whether there will be another lockdown or similar and, if there is, whether there would be significant fiscal support from the Government for businesses and jobs.

- There were already increasing grounds for viewing the economic recovery as running out of steam during the autumn and now into the winter. And then along came Omicron to pose a significant downside threat to economic activity. This could lead into stagflation, or even into recession, which would then pose a dilemma for the MPC as to whether to focus on combating inflation or supporting economic growth through keeping interest rates low.

- Will some current key supply shortages spill over into causing economic activity in some sectors to take a significant hit?

- Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation.

- On the other hand, consumers are sitting on over £160bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?

- It looks as if the economy coped well with the end of furlough on 30th September. It is estimated that there were around 1 million people who came off furlough then and there was not a huge spike up in unemployment. The other side of the coin is that vacancies have been hitting record levels so there is a continuing acute shortage of workers. This is a potential danger area if this shortage drives up wages which then feed through into producer prices and the prices of services i.e., a second-round effect that the MPC would have to act against if it looked like gaining significant momentum.

- We also recognise there could be further nasty surprises on the Covid front beyond the Omicron mutation.

- If the UK invokes article 16 of the Brexit deal over the dislocation in trading arrangements with Northern Ireland, this has the potential to end up in a no-deal Brexit.

In summary, with the high level of uncertainty prevailing on several different fronts, we expect to have to revise our forecasts again - in line with whatever the new news is.

It should also be borne in mind that Bank Rate being cut to 0.25% and then to 0.10%, were emergency measures to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away such emergency cuts on no other grounds than they are no longer warranted, and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

2.5 **Forecasts for PWLB rates and gilt and treasury yields**

Since the start of 2021, we have seen a lot of volatility in gilt yields, and hence PWLB rates. As the interest forecast table for PWLB certainty rates above shows, there is forecast to be a steady, but slow, rise in both Bank Rate and gilt yields during the forecast period to March 2025, though there will doubtless be a lot of unpredictable volatility during this forecast period.

While monetary policy in the UK will have a major impact on gilt yields, there is also a need to consider the potential impact that rising treasury yields in America could have on our gilt yields. **As an average since 2011, there has been a 75% correlation between movements in US 10-year treasury yields and UK 10-year gilt yields. This is a significant UPWARD RISK exposure to our forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.**

US treasury yields. During the first part of 2021, US President Biden's, and the Democratic party's, determination to push through a $1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid pandemic was what unsettled financial markets. However, this was in addition to the $900bn support package already passed in December 2020. This was then followed by additional Democratic ambition to spend $1trn on infrastructure, (which was eventually passed by both houses later in 2021), and an even larger sum on an American families plan over the next decade; this is still caught up in Democrat / Republican haggling. Financial markets were alarmed that all this stimulus was happening at a time when: -

1. A fast vaccination programme had enabled a rapid opening up of the economy during 2021.
2. The economy was growing strongly during the first half of 2021 although it has weakened overall during the second half.
3. It started from a position of little spare capacity due to less severe lockdown measures than in many other countries.
4. And the Fed was still providing substantial stimulus through monthly QE purchases during 2021.

It was not much of a surprise that a combination of these factors would eventually cause an excess of demand in the economy which generated strong inflationary pressures. This has eventually been recognised by the Fed at its December meeting with an aggressive response to damp inflation down during 2022 and 2023.

At its 3rd November Fed meeting, the Fed decided to make a start on tapering its $120bn per month of QE purchases so that they ended next June. However, at its **15th December meeting** it doubled the pace of tapering so that they will end all purchases in February. These purchases are currently acting as downward pressure on treasury yields and so it would be expected that Treasury yields will rise over the taper period and after the taper ends, all other things being equal. The Fed also forecast that it expected there would be three rate rises in 2022 of 0.25% from near zero currently, followed by three in 2023 and two in 2024, taking rates back above 2% to a neutral level for monetary policy.

There are also possible **DOWNSIDE RISKS** from the huge sums of cash that the UK populace have saved during the pandemic; when savings accounts earn little interest, it is likely that some of this cash mountain could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down. How this will interplay with the Bank of England eventually getting round to not reinvesting maturing gilts and then later selling gilts, will be interesting to monitor.

There is likely to be **exceptional volatility and unpredictability in respect of gilt yields and PWLB rates** due to the following factors: -

- How strongly will changes in gilt yields be correlated to changes in US treasury yields (see below). Over 10 years since 2011 there has been an average 75% correlation between movements in US treasury yields and gilt yields. However, from time to time these two yields can diverge. Lack of spare economic capacity and rising inflationary pressures are viewed as being much greater dangers in the US than in the UK. This could mean that central bank rates will end up rising earlier and higher in the US than in the UK if inflationary pressures were to escalate; the consequent increases in treasury yields could well spill over to cause (lesser) increases in gilt yields. There is, therefore, an upside risk to forecasts for gilt yields due to this correlation. The Link Group forecasts have included a risk of a 75% correlation between the two yields.
- Will the Fed take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong will inflationary pressures actually turn out to be in both the US and the UK and so put upward pressure on treasury and gilt yields?
- How will central banks implement their new average or sustainable level inflation monetary policies?
- How well will central banks manage the withdrawal of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets as happened in the "taper tantrums" in the US in 2013?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

As the US financial markets are, by far, the biggest financial markets in the world, any upward trend in treasury yields will invariably impact and influence financial markets in other countries. Inflationary pressures and erosion of surplus economic capacity look much stronger in the US compared to those in the UK, which would suggest that Fed rate increases eventually needed to suppress inflation, are likely to be faster and stronger than Bank Rate increases in the UK. This is likely to put upward pressure on treasury yields which could then spill over into putting upward pressure on UK gilt yields.

The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within the forecasting period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and Russia, China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

The balance of risks to medium to long term PWLB rates: -

- There is a balance of upside risks to forecasts for medium to long term PWLB rates.

2.6 **A new era for local authority investing**

– a fundamental shift in central bank monetary policy

One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the ECB, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on 'achieving broad and inclusive "maximum" employment in its entirety' in the US, before consideration would be given to increasing rates.

- The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.
- The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' before starting on raising Bank Rate and the ECB now has a similar policy.
- ***For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.***

- Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures.
- Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt; (in the UK this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.

2.7 **Investment and borrowing rates**

- **Investment returns** are expected to improve in 2022/23. However, while markets are pricing in a series of Bank Rate hikes, actual economic circumstances may see the MPC fall short of these elevated expectations.

- **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 and still remain at historically low levels. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.

- On 25.11.20, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates which had been increased by 100 bps in October 2019. The standard and certainty margins were reduced by 100 bps 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 current 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)

Interest rate forecast: The Council's treasury management adviser Link Group is forecasting that Bank Rate will rise in calendar Q2 2022 to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates.

A more detailed economic and interest rate forecast provided by Link Group is attached at Annex 2.

3. **Local Context:**

3.1 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

3.2 Internal borrowing allows the Council to utilise its internal cash balances (i.e. working capital and reserves) which are not required in the short to medium-term in order to reduce risk and keep interest costs low. Forecast gross external debt and capital financing requirement are shown in the table 1 below.

Table 1: Prudential Indicator: Forecast Gross External Debt and the Capital Financing Requirement

	31.3.2021 Actual £m	31.3.2022 Estimate £m	31.3.2023 Estimate £m	31.3.2024 Estimate £m	31.3.2025 Estimate £m
HRA Debt	56.9	61.2	61.2	61.2	61.2
General Fund External Debt	43.4	43.4	43.4	43.4	43.4
Other Long-Term Liabilities	0	0	0	0	0
Total Debt	**100.3**	**104.6**	**104.6**	**104.6**	**104.6**
Capital Financing Requirement	108.3	114.4	118.6	122.3	121.9
CFR not funded by Borrowing	8.0	9.8	14.0	17.7	17.3

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

4. **Borrowing Strategy**

4.1 The Council's main objective when borrowing money is to strike an appropriate balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. To achieve this, the key aim is to maximise internal borrowing and use cash surpluses to avoid the need to borrow externally until needed.

4.2 By doing so, the Council is able to supress net borrowing costs (despite foregone investment income) and limit market and credit risk in the investment portfolio.

4.3 The level and mix of investments and borrowing will be reviewed on a regular basis, taking account of the overall cash position and market forecasts. Link Group will assist in this review with this analysis, which will support decisions on whether to take additional longer-term external borrowing at fixed rates over the medium-term, with a view to keeping future interest costs low.

4.4 The Council could consider short-term low rate borrowing from counterparties such as other local authorities if it had a temporary cash shortfall that needed to be addressed, rather than committing unnecessarily to long-term lending before it is needed.

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

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

- HM Treasury's Public Works Loan Board (PWLB);
- any institution approved for investments (see below);
- banks or building societies authorised to operate in the UK;
- UK Local Authorities;
- UK public and private sector pension funds (except the Surrey Pension Fund);
- capital market bond investors; and
- UK Municipal Bonds Agency plc and other special purpose companies created to enable Local Authority bond issues.

4.7 The Council has raised its long-term borrowing from the PWLB. For short-term borrowing if it was considered necessary in the future the Council could use other sources of finance, such as loans from other Local Authorities, pension funds and other public bodies as these are often available at more favourable rates. These short-term loans leave the Council exposed to the risk of interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

4.8 HM Treasury have recently closed a consultation on changes to the terms and conditions of their lending through PWLB. The revised approach to lending has resulted in a significant reduction in interest rates (at time of writing 1.99% for a 40-year loan), however Local Authorities will no longer be able to access PWLB lending if they pursue 'debt-for-yield' (commercial investment) acquisitions. The Council's Treasury Management Strategy assumes that capital plans will remain compliant with new PWLB terms and conditions and that we will therefore retain access to the lending facility.

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

- leasing
- hire purchase
- Private Finance Initiative (PFI)
- sale and leaseback

All such sources of finance are subject to a robust options appraisal.

4.10 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to Local Authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow through the Agency will therefore be the subject of a separate report. Our current strategy is in favour of PWLB borrowing for long term debt due to ease of access to borrowing and low rates, however this is periodically reviewed with Link Group and when a decision for increased long-term borrowing is made all options will be scrutinised.

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

Borrowing Costs

4.12 Gross borrowing costs include interest payable and the statutory charge on the general fund for MRP. The borrowing costs associated with the 2022/23 to 2024/25 Capital Programme increase from £2.3m in 2022/23 to £2.4m by 2024/25.

4.13 Net borrowing costs are calculated after offsetting interest and investment income and over the same period, net borrowing costs grow from £0.7m in 2022/23 to £0.8m in 2024/25.

5. Treasury Investment Strategy

5.1 **Objectives:** The CIPFA Code requires the Council to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. The Fund Manager Selection report on this Investment Sub Committee agenda sets out a proposed approach.

5.2 **Negative interest rates: Earlier in the pandemic,** Covid-19 increased the risk that the Bank of England will set its Bank Rate at or below zero. This now looks less likely, however the eventuality should be considered. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. In this event, security would be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

5.3 **Strategy:** Due to the continuation of the strategy to maximise internal borrowing, investment levels are expected to remain at broadly the same level during 2022/23 as set out in the Fund Manager Selection report on this Investment Sub Committee Agenda. It is proposed that any short term cash surpluses are invested in money market funds and short-term unsecured bank deposits. Money Market Funds offer same-day liquidity, very low or no volatility and also ensure diversification to reduce the security risk of holding the majority of cash deposits with a limited number of UK banks.

5.4 Money Market Funds and short-term bank deposits will be utilised, with a cash limit per counterparty/fund of £4m. If the economic situation changes, which results in a decision to undertake additional borrowing, resulting in higher cash balances, other investment counterparties may be considered and the counterparty limits set out below would apply.

5.5 **Business models**: Under the new International Financial Reporting Standard (IFRS 9) standard, the accounting for certain investments depends on the Council's "business model" for managing them. The new standard requires entities to account for expected credit losses in a timely manner; from the moment when financial instruments are first identified. These investments will continue to be accounted for at amortised cost.

5.6 **Approved counterparties**: The Council may invest its surplus funds with any of the counterparty types in Table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 2 - Approved investment counterparties and limits

High Credit Quality	Individual Monetary limit for initial investment[1]	Aggregate Monetary Limit	Fitch Credit rating[3]
UK Central Government	No Limit	No Limit	Not applicable
UK Local Authorities including PCC's	£2m each	LT: £8m	Not applicable
Banks[1] operating in the UK[2]	£2m each	LT: £8m ST: None	LT:A- ST: F1
Overseas Banks (subject to Sovereign Rating AA-)	£2m each	£8m	LT:A- ST: F1
UK building societies with an asset base > £1bn	£2m each		LT: BBB+ ST:F1
UK building societies with an asset base < £1bn	£1m each		LT: A- ST:F1
Money Market Funds	£4m each		ST: AAA
Ultra Short Dated Bond Fund	£4m each		ST: AAA
Pooled Funds[4]			
Bond Funds without credit ratings	£4m each	£8m	Not applicable
Property Funds without credit ratings	£4m each	£4m	Not applicable
Multi Asset Funds	£4m each	£8m	Not applicable
Long Term Loans to small business ranked no lower than average risk by independent credit analysis	£100,000	£6m	Not applicable
Company shares to participate in the UK Municipal Bonds Agency	£10,000	£10,000	Not applicable

[1] banks within the same group ownership are treated as one bank for limit purposes
[2] where the bank is used as a reserve account the criteria will exclude consideration of the long-term credit rating
[3] Minimum Credit rating required, is expressed as a Fitch rating or the equivalent S&P or Moodys ratings etc
[4] The Council has placed an overall limit on pooled funds of £16m

The majority of the Council's investments activity will be made for relatively short periods and in highly credit rated investments, giving priority to security and liquidity ahead of yield. In order that the Council is not at risk of a large single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £2 million or £4 million per pooled fund. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

5.7 **Minimum credit rating:** Treasury investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

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

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

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

5.11 **Pooled funds:** Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

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

5.13 **Operational bank accounts:** The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB - and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £1m. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity. The Council's bank, HSBC, has a credit rating of AA-.

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

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

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

5.16 **Other information on the security of investments**: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis. No investments will be made with an organisation if there are substantive doubts about its credit quality.

5.17 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills or with other Local Authorities.

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

Treasury Management Indicators

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

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

Debt Maturity Profile Limits	**Actual as at 31/03/21**	**Upper Limit 2021/22**
	%	%
Under 1 year	2	15
1 to 2 years	3	15
2 to 5 years	10	25
5 years to 10 years	26	50
More than 10 years	8	50
Over 20 years	51	60
Total	**100%**	

Time periods start on the first day of each financial year. The maturity date of borrowing is the date of the loans are due to be repaid.

5.21 **Interest rate exposures:** This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as net principal borrowed will be:

	2022/23 £m	2023/24 £m	2024/25 £m
Upper limit on fixed interest rate exposures	285	285	285
Upper limit on variable interest rate exposures	60	60	60

5.22 Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

5.23 **Principal sums invested for periods longer than 364 days:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The recommendation for the upper limit of principal sums maturing beyond the year end is £16m, as shown below:

Price risk indicator	2022/23	2023/24	2024/25
Limit on principal invested beyond year end	£16m	£16m	£16m

Other Items

5.24 There are a number of additional items that the Council is obliged by CIPFA and DLUHC to include in its treasury management strategy.

5.25 **Treasury Management Advice:** Tandridge District Council has appointed Link Group as Treasury management advisers and receives specific advice on investments, debt and capital finance matters.

5.26 **Treasury Management Training**: Member and Officer training needs are assessed regularly as part of the staff appraisal process. Additional training will be provided as and when there is a change in roles and responsibilities. The Council also benefits from the Orbis partnership Centre of Expertise as part of the Joint Working Arrangement with Surrey County Council, which provides a robust Treasury team providing day to day treasury management operational activities to Tandridge District Council, Surrey County Council, Brighton & Hove City Council and East Sussex County Council.

Knowledge and Skills

As part of the Joint Working arrangement with Surrey County Council:

5.27 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. The Council pays for officers to study towards relevant professional qualifications including CIPFA.

5.28 All officers involved in the treasury and investment management function have access to relevant technical guidance and training to enable them to acquire and maintain the appropriate level of expertise, knowledge and skills to undertake the duties and responsibilities allocated to them. The Council currently employs treasury management advisors through Link Group. The Council's Treasury Management and borrowing strategies are supported by guidance from our advisors, Link Group. Both are on hand to guide key decisions and provide proactive advice in response to emerging market trends.

5.29 The Orbis partnership enables the creation and development of specialist resources. Centres of Expertise have been established for key areas of finance, and central teams of pooled expertise have been created to provide robust services which are resilient to meet the changing service needs of partners.

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

6. **Financial Implications**

6.1 The budget for investment income in 2022/23 is £1.5m. The budget for debt interest paid in 2022/23 is £1.1m (GF) and £1.7m (HRA), which is based on the existing long-term fixed rate debt portfolio.

6.2 The CIPFA Code does not prescribe any particular treasury management strategy for Local Authorities to adopt. The Section 151 Officer believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller

Prudential Indicators 2022/23 – 2024/25

1.1 The Local Government Act 2003 requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of Local Authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

1.2 The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice.

Estimates of capital expenditure

1.3 The Council's planned capital expenditure and financing is summarised in table 1 (para 2.5) and table 2 (para 2.12) of the main strategy. This prudential indicator is a summary of the Council's annual capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

The Council's borrowing need (the capital financing requirement)

1.4 Table 4 (para 2.17) of the main strategy sets out the Council's estimated capital financing requirement (CFR). The CFR represents capital expenditure funded by external debt and internal borrowing and not by capital receipts, revenue contributions, capital grants or third party contributions at the time of spending. The CFR therefore measures a Council's underlying need to borrow for a capital purpose. Any capital expenditure which has not been funded from locally determined resources will increase the CFR. The CFR will reduce by the Minimum Revenue Provision (MRP).

1.5 The MRP is a statutory annual revenue charge which reduces the borrowing need in a similar way to paying principal off a household mortgage.

1.6 The CFR would include 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 and they therefore do not form part of the Council's underlying need to borrow.

Gross borrowing and the capital financing requirement

1.7 In order to ensure that over the medium-term borrowing will only be for a capital purpose, the Council should ensure that its 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 the current and next 2 financial years. This allows some flexibility for early borrowing in advance of need, but ensures that borrowing is not undertaken for revenue purposes. This is a key indicator of prudence, see Table 1, para 3.2 TMSS.

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

The Council's authorised limit and operational boundary for external debt

1.8 Table 1 sets out the Council's authorised limit and operational boundary for external debt.

1.9 The authorised limit represents a control on the maximum level of borrowing. It is a statutory limit determined under section 3(1) of the Local Government Act 2003 and represents a limit beyond which external debt is prohibited. It is the maximum amount of debt that the Council can legally owe.

1.10 The operational boundary is an indicator against which to monitor its external debt position. It is based on the Council's estimate of the most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Council's estimates of capital expenditure, the CFR and cash flow requirements and is a key management to for in-year monitoring.

1.11 Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified. Other long-term liabilities comprise finance lease, PFIs and other liabilities that are not borrowing but form part of the Council's debt position.

1.12 The operational boundary is not a limit and actual borrowing could vary around this boundary for short periods during the year. It should act as an indicator to ensure the authorised limit is not breached. The operational boundary increases over the MTFS period to reflect an increasing underlying need to borrow linked to the Capital Programme. We monitor against the indicator throughout the year.

1.13 The Authorised limit provides headroom over and above the operational boundary for unusual cash movements and potential additional borrowing to meet the ambitions of the Council in respect of its investment strategy.

Table 1: Prudential Indicators: Authorised limit and operational boundary for external debt

	2021/22 limit £m	**2022/23 limit £m**	**2023/24 limit £m**	**2024/25 limit £m**
Authorised limit – borrowing	150	150	150	150
Authorised limit – leases	0	0	0	0
Authorised limit – total external debt	150	150	150	150
Operational boundary – borrowing	140	140	140	140
Operational boundary – leases	0	0	0	0
Operational boundary – total external debt	140	140	140	140

Estimated ratio of net financing costs to net revenue stream

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

Table 2: Prudential Indicator: Proportion of financing costs to net revenue stream

	2022/23 Estimate £m	**2023/24 Estimate £m**	**2024/25 Estimate £m**
Net revenue stream	11.4	11.0	11.0*
General Fund - Net Financing costs	0.7	0.9	0.7
Proportion of GF net financing costs to net revenue stream	6%	8%	6%

*The MTFS goes to 2023/24 and so the figure here for 2024/25 net revenue stream is provisional.

Link Group Economic & Interest Rate Forecast

External Context

ECONOMIC BACKGROUND

COVID-19 vaccines.

These were the game changer during 2021 which raised high hopes that life in the UK would be able to largely return to normal in the second half of the year. However, the bursting onto the scene of the Omicron mutation at the end of November, rendered the initial two doses of all vaccines largely ineffective in preventing infection. This has dashed such hopes and raises the spectre again that a fourth wave of the virus could overwhelm hospitals in early 2022. What we now know is that this mutation is very fast spreading with the potential for total case numbers to double every two to three days, although it possibly may not cause so much severe illness as previous mutations. Rather than go for full lockdowns which heavily damage the economy, the government strategy this time is focusing on getting as many people as possible to have a third (booster) vaccination after three months from the previous last injection, as a booster has been shown to restore a high percentage of immunity to Omicron to those who have had two vaccinations. There is now a race on between how quickly boosters can be given to limit the spread of Omicron, and how quickly will hospitals fill up and potentially be unable to cope. In the meantime, workers have been requested to work from home and restrictions have been placed on large indoor gatherings and hospitality venues. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in sectors like restaurants, travel, tourism and hotels which had been hit hard during 2021, but could now be hit hard again by either, or both, of government restrictions and/or consumer reluctance to leave home. Growth will also be lower due to people being ill and not working, similar to the pingdemic in July. The economy, therefore, faces significant headwinds although some sectors have learned how to cope well with Covid. However, the biggest impact on growth would come from another lockdown if that happened. The big question still remains as to whether any further mutations of this virus could develop which render all current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread until tweaked vaccines become widely available.

A SUMMARY OVERVIEW OF THE FUTURE PATH OF BANK RATE

- In December, the Bank of England became the first major western central bank to put interest rates up in this upswing in the current business cycle in western economies as recovery progresses from the Covid recession of 2020.
- The next increase in Bank Rate could be in February or May, dependent on how severe an impact there is from Omicron.
- If there are lockdowns in January, this could pose a barrier for the MPC to putting Bank Rate up again as early as 3rd February.
- With inflation expected to peak at around 6% in April, the MPC may want to be seen to be active in taking action to counter inflation on 5th May, the release date for its Quarterly Monetary Policy Report.
- The December 2021 MPC meeting was more concerned with combating inflation over the medium term than supporting economic growth in the short term.

- Bank Rate increases beyond May are difficult to forecast as inflation is likely to drop sharply in the second half of 2022.
- However, the MPC will want to normalise Bank Rate over the next three years so that it has its main monetary policy tool ready to use in time for the next down-turn; all rates under 2% are providing stimulus to economic growth.
- We have put year end 0.25% increases into Q1 of each financial year from 2023 to recognise this upward bias in Bank Rate - but the actual timing in each year is difficult to predict.
- Covid remains a major potential downside threat in all three years as we ARE likely to get further mutations.
- How quickly can science come up with a mutation proof vaccine, or other treatment, – and for them to be widely administered around the world?
- Purchases of gilts under QE ended in December. Note that when Bank Rate reaches 0.50%, the MPC has said it will start running down its stock of QE.

MPC MEETING 16H DECEMBER 2021

- The Monetary Policy Committee (MPC) voted 8-1 to raise Bank Rate by 0.15% from 0.10% to 0.25% and unanimously decided to make no changes to its programme of quantitative easing purchases due to finish in December 2021 at a total of £895bn.

- The MPC disappointed financial markets by not raising Bank Rate at its November meeting. Until Omicron burst on the scene, most forecasters, therefore, viewed a Bank Rate increase as being near certain at this December meeting due to the way that inflationary pressures have been comprehensively building in both producer and consumer prices, and in wage rates. However, at the November meeting, the MPC decided it wanted to have assurance that the labour market would get over the end of the furlough scheme on 30th September without unemployment increasing sharply; their decision was, therefore, to wait until statistics were available to show how the economy had fared at this time.

- **On 10th December we learnt of the disappointing 0.1% m/m rise in GDP** in October which suggested that economic growth had already slowed to a crawl even before the Omicron variant was discovered in late November. Early evidence suggests growth in November might have been marginally better. Nonetheless, at such low rates of growth, the government's "Plan B" COVID-19 restrictions could cause the economy to contract in December.

- **On 14th December, the labour market statistics** for the three months to October and the single month of October were released. The fallout after the furlough scheme was smaller and shorter than the Bank of England had feared. The single-month data were more informative and showed that LFS employment fell by 240,000, unemployment increased by 75,000 and the unemployment rate rose from 3.9% in September to 4.2%. However, the weekly data suggested this didn't last long as unemployment was falling again by the end of October. What's more, the 49,700 fall in the claimant count and the 257,000 rise in the PAYE measure of company payrolls suggests that the labour market strengthened again in November. The other side of the coin was a further rise in the number of vacancies from 1.182m to a record 1.219m in the three months to November which suggests that the supply of labour is struggling to keep up with demand, although the single-month figure for November fell for the first time since February, from 1.307m to 1.227m.

- These figures by themselves, would probably have been enough to give the MPC the assurance that it could press ahead to raise Bank Rate at this December meeting. However, the advent of Omicron potentially threw a spanner into the works as it poses a major headwind to the economy which, of itself, will help to cool the economy. The financial markets, therefore, swung round to expecting no change in Bank Rate.

- **On 15th December we had the CPI inflation** figure for November which spiked up further from 4.2% to 5.1%, confirming again how inflationary pressures have been building sharply. However, Omicron also caused a sharp fall in world oil and other commodity prices; (gas and electricity inflation has generally accounted on average for about 60% of the increase in inflation in advanced western economies).

- **Other elements of inflation are also transitory** e.g., prices of goods being forced up by supply shortages, and shortages of shipping containers due to ports being clogged have caused huge increases in shipping costs. But these issues are likely to clear during 2022, and then prices will subside back to more normal levels. Gas prices and electricity prices will also fall back once winter is passed and demand for these falls away.

- Although it is possible that the Government could step in with some **fiscal support for the economy**, the huge cost of such support to date is likely to pose a barrier to incurring further major economy wide expenditure unless it is very limited and targeted on narrow sectors like hospitality, (as announced just before Christmas). The Government may well, therefore, effectively leave it to the MPC, and to monetary policy, to support economic growth – but at a time when the threat posed by rising inflation is near to peaking!

- This is the adverse set of factors against which the MPC had to decide on Bank Rate. For the second month in a row, the MPC blind-sided financial markets, this time with a **surprise increase in Bank Rate from 0.10% to 0.25%.** What's more, the hawkish tone of comments indicated that the MPC is now concerned that inflationary pressures are indeed building and need concerted action by the MPC to counter. This indicates that there will be more increases to come with financial markets predicting 1% by the end of 2022. The 8-1 vote to raise the rate shows that there is firm agreement that inflation now poses a threat, especially after the CPI figure hit a 10-year high this week. The MPC commented that "there has been significant upside news" and that "there were some signs of greater persistence in domestic costs and price pressures".

- On the other hand, it did also comment that **"the Omicron variant is likely to weigh on near-term activity".** But it stressed that at the November meeting it had said it <u>would</u> raise rates if the economy evolved as it expected and that now "these conditions had been met". It also appeared more worried about the possible boost to inflation form Omicron itself. It said that "the current position of the global and UK economies was materially different compared with prior to the onset of the pandemic, including elevated levels of consumer price inflation". It also noted the possibility that renewed social distancing would boost demand for goods again, (as demand for services would fall), meaning "global price pressures might persist for longer". (Recent news is that the largest port in the world in China has come down with an Omicron outbreak which is not only affecting the port but also factories in the region.)

- On top of that, there were no references this month to inflation being expected to be below the **2% target in two years' time,** which at November's meeting the MPC referenced to suggest the markets had gone too far in expecting interest rates to rise to over 1.00% by the end of the year.

- These comments indicate that there has been a material reappraisal by the MPC of the inflationary pressures since their last meeting and the Bank also increased its forecast for inflation to peak at 6% next April, rather than at 5% as of a month ago. However, as the Bank retained its guidance that only **a "modest tightening"** in policy will be required, it cannot be thinking that it will need to increase interest rates that much more. A typical policy tightening cycle has usually involved rates rising by 0.25% four times in a year. "Modest" seems slower than that. As such, the Bank could be thinking about raising interest rates two or three times next year to 0.75% or 1.00%.

- In as much as a considerable part of the inflationary pressures at the current time are indeed **transitory,** and will naturally subside, and since economic growth is likely to be weak over the next few months, this would appear to indicate that this tightening cycle is likely to be comparatively short.

- As for the timing of the next increase in Bank Rate, the MPC dropped the comment from November's statement that Bank Rate would be raised "in the coming months". That may imply another rise is unlikely at the next meeting in February and that May is more likely. However, much could depend on how adversely, or not, the economy is affected by Omicron in the run up to the next meeting on 3rd February. Once 0.50% is reached, the Bank would act to start shrinking its stock of QE, (gilts purchased by the Bank would not be replaced when they mature).

- **The MPC's forward guidance on its intended monetary policy** on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -
  - Raising Bank Rate as "the active instrument in most circumstances".
  - Raising Bank Rate to 0.50% before starting on reducing its holdings.
  - Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
  - Once Bank Rate had risen to at least 1%, it would start selling its holdings.

- **US.** Shortages of goods and intermediate goods like semi-conductors, have been fuelling increases in prices and reducing economic growth potential. In November, **CPI inflation hit a near 40-year record level of 6.8%** but with energy prices then falling sharply, this is probably the peak. The biggest problem for the Fed is the mounting evidence of a strong pick-up in cyclical price pressures e.g., in rent which has hit a decade high.

- **Shortages of labour** have also been driving up wage rates sharply; this also poses a considerable threat to feeding back into producer prices and then into consumer prices inflation. It now also appears that there has been a sustained drop in the labour force which suggests the pandemic has had a longer-term scarring effect in reducing potential GDP. Economic growth may therefore be reduced to between 2 and 3% in 2022 and 2023 while core inflation is likely to remain elevated at around 3% in both years instead of declining back to the Fed's 2% central target.

- Inflation hitting 6.8% and the feed through into second round effects, meant that it was near certain that the **Fed's meeting of 15th December** would take aggressive action against inflation. Accordingly, the rate of tapering of monthly $120bn QE purchases announced at its November 3rd meeting. was doubled so that all purchases would now finish in February 2022. In addition, Fed officials had started discussions on running down the stock of QE held by the Fed. Fed officials also expected three rate rises in 2022 of 0.25% from near zero currently, followed by three in 2023 and two in 2024, taking rates back above 2% to a neutral level for monetary policy. The first increase could come as soon as March 2022 as the chairman of the Fed stated his view that the economy had made rapid progress to achieving the other goal of the Fed – "maximum employment". The Fed forecast that inflation would fall from an average of 5.3% in 2021 to 2.6% in 2023, still above its target of 2% and both figures significantly up from previous forecasts. What was also significant was that this month the Fed dropped its description of the current level of inflation as being "transitory" and instead referred to "elevated levels" of inflation: the statement also dropped most of the language around the flexible average inflation target, with inflation now described as having exceeded 2 percent "for some time". It did not see Omicron as being a major impediment to the need to take action now to curtail the level of inflationary pressures that have built up, although Fed officials did note that it has the potential to exacerbate supply chain problems and add to price pressures.
  See also comments in paragraph 3.3 under PWLB rates and gilt yields.

- **EU.** The slow role out of vaccines initially delayed **economic recovery** in early 2021 but the vaccination rate then picked up sharply. After a contraction of -0.3% in Q1, Q2 came in with strong growth of 2%. With Q3 at 2.2%, the EU recovery was then within 0.5% of its pre Covid size. However, the arrival of Omicron is now a major headwind to growth in quarter 4 and the expected downturn into weak growth could well turn negative, with the outlook for the first two months of 2022 expected to continue to be very weak.

- **November's inflation figures** breakdown shows that the increase in price pressures is not just due to high energy costs and global demand-supply imbalances for durable goods as services inflation also rose. Headline inflation reached 4.9% in November, with over half of that due to energy. However, oil and gas prices are expected to fall after the winter and so energy inflation is expected to plummet in 2022. Core goods inflation rose to 2.4% in November, its second highest ever level, and is likely to remain high for some time as it will take a long time for the inflationary impact of global imbalances in the demand and supply of durable goods to disappear. Price pressures also increased in the services sector, but wage growth remains subdued and there are no signs of a trend of faster wage growth which might lead to *persistently* higher services inflation - which would get the ECB concerned. The upshot is that the euro-zone is set for a prolonged period of inflation being above the ECB's target of 2% and it is likely to average 3% in 2022, in line with the ECB's latest projection.

- **ECB tapering.** The ECB has joined with the Fed by also announcing at its meeting on 16th December that it will be reducing its QE purchases - by half from October 2022, i.e., it will still be providing significant stimulus via QE purchases for over half of next year. However, as inflation will fall back sharply during 2022, it is likely that it will leave its central rate below zero, (currently -0.50%), over the next two years. The main struggle that the ECB has had in recent years is that inflation has been doggedly anaemic in sticking below the ECB's target rate despite all its major programmes of monetary easing by cutting rates into negative territory and providing QE support.

- The ECB will now also need to consider the impact of **Omicron** on the economy, and it stated at its December meeting that it is prepared to provide further QE support if the pandemic causes bond yield spreads of peripheral countries, (compared to the yields of northern EU countries), to rise. However, that is the only reason it will support peripheral yields, so this support is limited in its scope.

- The EU has entered into a **period of political uncertainty** where a new German government formed of a coalition of three parties with Olaf Scholz replacing Angela Merkel as Chancellor in December 2021, will need to find its feet both within the EU and in the three parties successfully working together. In France there is a presidential election coming up in April 2022 followed by the legislative election in June. In addition, Italy needs to elect a new president in January with Prime Minister Draghi being a favourite due to having suitable gravitas for this post. However, if he switched office, there is a significant risk that the current government coalition could collapse. That could then cause differentials between Italian and German bonds to widen when 2022 will also see a gradual running down of ECB support for the bonds of weaker countries within the EU. These political uncertainties could have repercussions on economies and on Brexit issues.

- **CHINA.** After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of **2020**; this enabled China to recover all the initial contraction. During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021.

- However, the pace of economic growth has now fallen back in **2021** after this initial surge of recovery from the pandemic and looks likely to be particularly weak in 2022. China has been struggling to contain the spread of the Delta variant through using sharp local lockdowns - which depress economic growth. Chinese consumers are also being very wary about leaving home and so spending money on services. However, with Omicron having now spread to China, and being much more easily transmissible, this strategy of sharp local lockdowns to stop the virus may not prove so successful in future. In addition, the current pace of providing boosters at 100 billion per month will leave much of the 1.4 billion population exposed to Omicron, and any further mutations, for a considerable time. The **People's Bank of China** made a start in December 2021 on cutting its key interest rate marginally so as to stimulate economic growth. However, after credit has already expanded by around 25% in just the last two years, it will probably leave the heavy lifting in supporting growth to fiscal stimulus by central and local government.

- Supply shortages, especially of coal for power generation, were causing widespread power cuts to industry during the second half of 2021 and so a sharp disruptive impact on some sectors of the economy. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

- **JAPAN.** 2021 has been a patchy year in combating Covid. However, recent business surveys indicate that the economy has been rebounding rapidly in 2021 once the bulk of the population had been double vaccinated and new virus cases had plunged. However, Omicron could reverse this initial success in combating Covid.

- The Bank of Japan is continuing its **very loose monetary policy** but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon: indeed, inflation was actually negative in July. New Prime Minister Kishida, having won the November general election, brought in a supplementary budget to boost growth, but it is unlikely to have a major effect.

- **WORLD GROWTH.** World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum in the second half of the year, though overall growth for the year is expected to be about 6% and to be around 4-5% in 2022. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. While headline inflation will fall sharply, core inflation will probably not fall as quickly as central bankers would hope. It is 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, and vice versa. This is likely to reduce world growth rates from those in prior decades.

- **SUPPLY SHORTAGES**. The pandemic and extreme weather events, followed by a major surge in demand after lockdowns ended, have been highly disruptive of extended worldwide supply chains. Major queues of ships unable to unload their goods at ports in New York, California and China built up rapidly during quarters 2 and 3 of 2021 but then halved during quarter 4. Such issues have led to a misdistribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. The latest additional disruption has been a shortage of coal in China leading to power cuts focused primarily on producers (rather than consumers), i.e., this will further aggravate shortages in meeting demand for goods. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods available to purchase.

Interest rate Forecasts 2021-2025 - PWLB forecasts shown have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Link Group Interest Rate View	20.12.21													
	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25
BANK RATE	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
3 month ave earnings	0.20	0.30	0.50	0.50	0.60	0.70	0.80	0.90	0.90	1.00	1.00	1.00	1.00	1.00
6 month ave earnings	0.40	0.50	0.60	0.60	0.70	0.80	0.90	1.00	1.00	1.10	1.10	1.10	1.10	1.10
12 month ave earnings	0.70	0.70	0.70	0.70	0.80	0.90	1.00	1.10	1.10	1.20	1.20	1.20	1.20	1.20
5 yr PWLB	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
10 yr PWLB	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
25 yr PWLB	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
50 yr PWLB	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30
Bank Rate														
Link	0.25	0.25	0.50	0.50	0.50	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25
Capital Economics	0.25	0.25	0.50	0.75	0.75	0.75	0.75	1.00	1.00	-	-	-	-	-
5yr PWLB Rate														
Link	1.40	1.50	1.50	1.60	1.60	1.70	1.80	1.80	1.80	1.90	1.90	1.90	2.00	2.00
Capital Economics	1.40	1.40	1.50	1.50	1.60	1.70	1.70	1.80	1.90	-	-	-	-	-
10yr PWLB Rate														
Link	1.60	1.70	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10	2.20	2.30
Capital Economics	1.60	1.60	1.70	1.70	1.80	1.80	1.90	2.00	2.00	-	-	-	-	-
25yr PWLB Rate														
Link	1.80	1.90	2.00	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.40	2.40	2.50	2.50
Capital Economics	1.80	1.80	1.90	1.90	2.00	2.10	2.10	2.20	2.30	-	-	-	-	-
50yr PWLB Rate														
Link	1.50	1.70	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.20	2.20	2.30	2.30
Capital Economics	1.40	1.50	1.60	1.70	1.80	1.90	2.00	2.20	2.30	-	-	-	-	-

Investment & Debt Portfolio Position as at 31 March 2021

	2020/21 Actual 31/03/2021 £m	2020/21 Actual 31/03/2021 %
Notice Accounts & Cash Plus Funds	4.0	0.3
Money Market Funds	7.3	0.1
Short-term Deposits	0	0
CCLA Property Fund	4.2	4.3
Funding Circle	0.9	5.7
Schroders Bond Fund	2.9	4.3
UBS Multi-Asset Fund	2.8	5.1
CCLA Diversification Fund	2.0	3.2
Total Treasury Investments	**24.1**	**2.5**
Long-term PWLB loans (HRA)	56.9	2.7
Long-term PWLB loans (GF)	43.4	2.6
Total Borrowing	**100.3**	**2.7**
Net Borrowing	**76.2**	

Glossary of Terms

CCLA – Churches, Charities and Local Authorities

CFR – Capital Financing Requirement

CIPFA – Chartered Institute of Public Finance Accountancy

CPI – Consumer Price Index

DMO – Debt Management Office

DMADF – Debt Management Account Deposit Facility

ECB – European Central Bank

GDP – Gross Domestic Product

DLUHC – Department for Levelling Up, Housing and Communities

MiFID - Markets in Financial Instruments Directive

MMF – Money Market Fund

MPC – Monetary Policy Committee

MRP – Minimum Revenue Provision

PWLB – Public Works Loan Board

TMSS – Treasury Management Strategy Statement

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