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South Cambridgeshire District Council

17 January 2019

To: Chairman – Councillor Grenville Chamberlain
Vice-Chairman – Councillor Brian Milnes
Members of the Scrutiny and Overview Committee – Councillors Ruth Betson, Anna Bradnam, Dr. Martin Cahn, Sarah Cheung Johnson, Gavin Clayton, Graham Cone, Dr. Claire Daunton, Dr. Douglas de Lacey, Bill Handley, Steve Hunt, Peter McDonald and Judith Rippeth
Quorum: 6

Dear Councillor

This is a supplement to the previously-published agenda for the meeting of **SCRUTINY AND OVERVIEW COMMITTEE** on **TUESDAY, 22 JANUARY 2019**, containing those reports which had not been received by the original publication deadline.

Yours faithfully
BEVERLY AGASS
Chief Executive

Requests for a large print agenda must be received at least 48 hours before the meeting.

AGENDA

		PAGES
6.	**General Fund and Housing Revenue Account (HRA) Budgets 2019-2020** Appendix 3 (Capital Strategy and Investment Strategy) and Appendix 4 (Treasury Management Strategy)	**1 - 46**

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Appendix 3

Capital and Investment Strategies 2019-20 to 2023-24

1. Introduction

1.1 The Capital Strategy forms a key part of the council's overall corporate planning framework. It provides the mechanism by which the council's capital investment and financing decisions can be aligned with the council's overarching corporate priorities and objectives over a medium term, five years, planning horizon.

1.2 The strategy sets the framework for all aspects of the council's capital expenditure; including planning, prioritisation, management and funding. The strategy has direct links to the council's corporate Asset Management Plan (AMP) and forms a key part of the council's Medium Term Financial Strategy (MTFS).

1.3 In addition to the Capital Strategy, the Council is now required to have an Investment Strategy and this is attached as Appendix 3 A.

1.4 The key aims of the Capital Strategy are to:

- Provide a clear context within which proposals for new capital expenditure are evaluated to ensure that all capital investment is targeted at meeting the council's vision, aims, approaches and actions;

- Deliver projects that focus on delivering revenue benefits in the form of spend to save, spend to earn or generate growth in revenue income;

- Set out how the council identifies, programmes and prioritises capital requirements and proposals arising from business plans, service plans, the AMP and other related strategies;

- Consider options available for funding capital expenditure and how resources may be maximised, to generate investment in the area, to determine an affordable and sustainable funding policy framework whilst minimising the ongoing revenue implications of any such investment;

- Identify the resources available for capital investment over the MTFS planning period; and

- Establish effective arrangements for the management of capital expenditure including the assessment of project outcomes, budget profiling, deliverability, and the achievement of value for money.

2. Capital programme needs and priorities

2.1 Underlying the Capital Strategy is the recognition that the financial resources available to meet corporate priorities are constrained in the current economic and political climate. Central government support for capital investment has reduced significantly over the last few years, along with these reductions is the recognition that the council must rely on internal resources and find ways in which investment decisions can be either self-sustaining or generate positive returns both in terms of meeting corporate objectives and producing revenue savings.

2.2 Against the background of limited central government support the AMP identifies the total capital investment needed to support the Council's aims and objectives such as housing and economic development.

2.3 Significant investment in council housing over the last few years has succeeded in producing a property portfolio generally at or above the decent homes standard and, the delivery of a new build programme with the first 61 new properties being completed by December 2017. Government proposals to reduce property rentals by 1% for 4 years from April 2016 have impacted the Council's ability to continue this level of programme in the longer term, necessitating a strategic review of assets, service delivery and financing. In the short to medium term a new build programme can be maintained by utilising resources previously ear-marked for potential debt redemption, but this does mean that the authority will need to re-finance its housing debt when it matures.

2.4 As the majority of the council's assets are housing there are limited opportunities to raise capital receipts through disposals, therefore the limited capital resources available through grant, capital receipts and private sector contributions are prioritised to maximise outputs with minimum ongoing future revenue costs.

2.5 Capital investment in the council's wholly owned subsidiary, Ermine Street Housing (ESH), offers the opportunity to realise interest receipts which will contribute to the council's revenue funding.

2.6 Cambridgeshire is an area of growth with the Greater Cambridge Partnership (formerly City Deal) offering financial support to deliver infrastructure to facilitate the delivery of homes and business space, as set out in the draft local plans for Cambridge City and South Cambridgeshire council areas. This will in turn contribute towards council funding in the longer term in the form of additional council tax and business rates receipts.

2.7 Another opportunity is the designation of Enterprise and Development Zones, including sites at Cambourne Business Park, Cambridge Research Park and Northstowe, which have the potential to offer incentives to enable the creation of new businesses and employment.

2.8 In detail:

- Economic Investment: The council will continue to seek investments that generate longer term growth. These projects will yield a combination of revenue generation (business rates or interest), jobs and capital infrastructure investment, based on sound business cases.

- Existing Housing: Significant investment has been made in recent years to raise the standard of council dwellings to meet the government's decent homes standard, In addition to the decent homes investment the authority invests in energy conservation projects such as external wall insulation, solar energy initiatives and renewable heating sources. Some planned energy conservation programmes will continue but within the changed and challenging restrictions resultant from future reductions in rental income.

- New Housing Supply and Housing Partnerships: South Cambridgeshire District Council are no longer formerly part of the joint venture with Cambridge City Council to deliver a shared governance Housing Development Agency, but continue to work closely with the authority on strategic housing delivery issues. South Cambridgeshire District Council are now managing a new build programme in-house, which is anticipated to deliver between 25 and 50 new homes per annum to meet local housing need. Opportunities to work with the Combined

Authority to deliver new affordable homes in the district are also being fully explored.

- Corporate Property: To manage its maintenance liability the council is rationalising its office accommodation through sub-let of office space, providing a contribution to ongoing revenue savings. A process of on-going reviews will identify potential alternative use of office buildings and car park for capital investment to generate long term revenue savings.

- ICT: The council's ICT service is shared with Cambridge City and Huntingdonshire District Councils, appropriate investment into ICT hardware and software will be undertaken on a case by case basis, the primary focus being improved technologies on a spend to save basis.

- Refuse and Recycling Collection: A shared trade and domestic waste collection service with Cambridge City Council supported by capital investment will achieve long term revenue savings through service rationalisation and vehicle efficiencies.

- Community Projects: Capital grants to other organisations where the council incurs no staff or other recurring costs; these organisations are expected to raise additional capital resources from the National Lottery, Sports Council, etc. The council has a funding toolkit on its website to assist organisations seeking funding.

3. Governance

3.1 The council has various mechanisms in place which seek to ensure that there is an integrated approach to addressing cross-cutting issues and developing and improving service delivery through its capital investment in pursuance of the council's over-arching aims.

3.2 An integrated service and financial planning process is followed. Within this framework all proposals for capital investment are required to demonstrate how they contribute to the council's aims and objectives. The evaluation process for investment proposals aligns corporate objectives with costs and benefits ensuring delivery of efficiency and value for money. Investment appraisal forms and the criteria for prioritising capital bids are available to managers on the Council intranet.

3.3 Specific governance processes include:

- Democratic decision making and scrutiny processes which provide overall political direction and ensure accountability for the investment in the capital programme. These processes include:
    - The Council which is ultimately responsible for approving investment and the capital programme;
    - The Cabinet which is responsible for setting the corporate framework and political priorities to be reflected in the capital programme, Cabinet receiving quarterly monitoring reports;
    - The Scrutiny and Overview Committee which is responsible for scrutiny of the Capital Strategy and capital programme.

- Officer groups which bring together a range of service interests and professional expertise. These include:
    - The Executive Management Team which has overall responsibility for the strategic development, management and monitoring of the capital programme;
    - Corporate Management Team, providing service manager review and monitoring of key areas;
    - Specific project boards with wide ranging membership, for example the Greater Cambridge Partnership Board;
    - Management teams which overview reports for investments prior to Executive Management Team and Cabinet approval;
    - Management groups, created to oversee significant capital projects as required.

3.4 Council assets are kept under review, valuations of land and property being undertaken by a professionally qualified valuer every five years, with an annual review at year end to ensure material changes in asset value are accounted for. The Corporate Asset Management Plan, Housing Revenue Account Business Plan and capital programme ensuring a comprehensive forward plan of maintenance and improvement work is maintained and delivered.

4. Funding strategy

4.1 In general terms, the major source of capital funding available to the council has been grant approvals allocated by central government to specific or non-specific projects. This is a diminishing resource and where a priority is identified alternative funds need to be sourced.

4.2 There are a range of other potential funding sources which may be generated locally either by the council or in partnership with others. Each project or programme will be subject to the approval process to include funding and lifetime costings of the asset going forward.

4.3 New sources of funding are being identified in partnership with neighbouring authorities and organisations, for example the Greater Cambridge Partnership.

4.4 Unallocated capital receipts received prior to April 2012 are available for general use and as such will be used for GF and/or HRA capital expenditure. Capital receipts received after April 2012 primarily relate to HRA property and land sales, the use of which is subject to detailed national regulations and associated guidance. The HRA Business Plan and council capital programme provide details of anticipated capital receipts and the proposed use of theses within the constraints imposed.

4.5 The council sets aside a Minimum Revenue Provision (MRP) for debt repayment in accordance with its MRP policy as set out in the Treasury Management and Investment Strategy presented alongside this Capital Strategy.

4.6 The Capital Strategy considers all potential funding options open to the council and aims to maximise the financial resources available for investment in service provision and improvement within the framework of the MTFS. The main sources of capital funding are summarised below:

- Central government
    - Grants are allocated in relation to specific programmes or projects and the council would seek to maximise such allocations, developing appropriate projects which reflect government and partnership led initiatives and agendas while addressing the needs of the district.
    - A significant amount of current funding is in the form of the New Homes Bonus (NHB) part of which is allocated to fund future capital infrastructure through the Greater Cambridge Partnership.

- Third party funding
    - Capital grants represent project specific funding for capital projects, in addition to those from central government, more usually received from quasi-

government sources or other national organisations. In developing capital proposals, the council will seek to maximise such external contributions, subject to any related grant conditions being consistent with the council's policy, aims and outcomes.

- Private contributions
  - The council will also seek to implement the new Community Infrastructure Levy to support on-going investment.
  - The council will continue to work with the private sector to utilise or re-purpose redundant assets to facilitate regeneration and employment creation.

- Locally generated funding
  - The council has discretion to undertake prudential 'unsupported' borrowing under the Prudential Code. This discretion is subject to compliance with the Code's regulatory framework which requires any such borrowing to be prudent, affordable and sustainable.
  - Given the pressure on the council's revenue budget in future years, prudent use will be made of this discretion in cases where there is a clear financial benefit such as invest to save, spend to earn or regeneration schemes which do not increase expenditure in the longer term.

- Capital receipts from asset disposal
  - The majority of disposals relate to dwellings sold under the government right to buy scheme, the scheme allows the retention of some of the receipts subject to certain conditions i.e. used to fund the delivery of new social housing to a maximum of 30% of any dwelling funded through this method, the balance being funded from the council's own resources or through borrowing.
  - Capital receipts from asset disposal are a finite funding source and it is important that a planned ad structured manner of disposals is created to support the priorities of the council. Cash receipts from the disposal of surplus assets are to be used to fund new capital investment as and when received.

- Lease finance
  - where alternative funding is not available for vehicles or minor equipment and the revenue budget does not allow for a full capital repayment and there is a robust business case then the option of leasing may be considered.

- Revenue

- Capital expenditure may be funded directly from revenue as specific budget provision, however, the general pressures on the council's revenue budget and council tax levels limits the extent to which this may be exercised as a source of capital funding.

4.7 Council resources will be allocated to programmes based on asset values to manage long term yield and revenue implications. Where possible capital receipts will be focussed on those assets with short term life span, e.g. vehicles and equipment, and the unsupported borrowing on long term assets e.g. land and buildings.

5. Capital programme

5.1 The council's capital programme and its funding for 2019/2020 to 2023/24 is summarised below. The detailed capital programmes for the GF and HRA can be found in the relevant Budget Setting Report (BSR).

Capital Programme 2019/20 to 2023/24

Capital Programme	Estimate 2019/2020 £'000	Estimate 2020/2021 £'000	Estimate 2021/2022 £'000	Estimate 2022/2023 £'000	Estimate 2023/2024 £'000
General Fund	15,923	20,435	3,332	3,294	3,569
Housing Revenue Account[1]	27,031	35,851	21,947	12,000	13,616
Total Capital Expenditure	42,954	56,286	25,279	15,294	17,185

[1] – HRA capital expenditure excludes the contribution to corporate ICT and therefore differs from totals in the HRA BSR.

Financed by :					
Capital Receipts	(6,796)	(8,821)	(5,066)	(4,233)	(3,094)
S106 Agreement Contribution	(3,058)	(9,342)	(4,252)	(3,937)	(1,404)
Cambridgeshire CC (DFG)	(630)	(630)	(630)	(630)	(630)
Revenue	(12,622)	(12,603)	(7,322)	0	(2,435)
Housing Capital Reserve	(6,689)	(6,868)	(7,032)	(5,714)	(8,567)
Revenue Contribution from HRA towards software etc.	(134)	(17)	(17)	(17)	(17)
Internal Borrowing re Commercial vehicles	0	(214)	(442)	(342)	(665)
Internal Borrowing re other projects	0	0	(146)	0	0
External funding from CCC for Waste Vehicles	0	(61)	(67)	0	(68)
Earmarked Reserves	(518)	(5,041)	(305)	(421)	(305)
External Borrowing	(12,507)	(12,689)	0	0	0
	(42,954)	(56,286)	(25,279)	(15,294)	(17.185)

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APPENDIX 3 A

DRAFT INVESTMENT STRATEGY

1. Introduction

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, the CIPFA Treasury Management Code of Practice (the Code) and MHCLG Investment Guidance (the Guidance) to ensure that the Council’s capital investment plans are affordable, prudent and sustainable.

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 other non-financial assets held primarily or partially to generate a profit. This wider definition includes investment property portfolios as well as loans made to wholly owned companies or associates, joint ventures or third parties. The Guidance applies for financial years commencing on or after 1 April 2018.

The Guidance requires the Strategy to be approved by Full Council on an annual basis and sets out the disclosure and reporting requirements. Any mid-year material changes to the Strategy will also be subject to Full Council approval.

The Guidance sets out the Government's position on borrowing in advance of need, which is that Authorities must not borrow more than, or in advance of their needs, purely to profit from the investment of the extra sums borrowed. The Council must have regard to the Guidance but is able to depart from it where such departure can be justified.

The Council has noted and has had regard to the Guidance. It has decided to depart from the Guidance in this instance, and within the parameters set out in this Strategy, for the purposes of delivering Business Plan objectives and maintaining a robust financial position. The Council has set out within this Strategy its approach to risk and risk mitigation, including the requirement for fully tested and scrutinised business cases, due diligence indicators and regular and formal reporting and scrutiny of investment decisions and performance.

2. The Strategy

The Strategy aims to provide a robust and viable framework for the acquisition of commercial property investments and pursuance of redevelopment and regeneration opportunities that can deliver positive financial returns for the Council.

Investments will be focussed within the District, the Greater Cambridge Partnership area and the Travel to Work Area as shown in Appendix A4.
Investment relating to the Strategy will be directed towards three streams of activity:

a) Stream 1

Prime and close to prime commercial real estate investment let on long leases to good covenants which will provide a secure long-term income over and above their ability to pay back the purchase price debt.

The contributions from Stream 1 investments will include:

- Yield / profit
- Long term capital uplift

b) Stream 2

Investment which can 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 income, New Homes Bonus where the investment is within the District and residential letting income from Build to Rent developments.

The contributions from Stream 2 investments will include positive financial returns for the Council, and may also include the following:

- Investing in climate and environmental initiatives
- Investing in Social Capital
- Redeveloping Council owned assets;
- Building homes and commercial premises;
- Using public land and buildings to achieve long term socio economic development within the District and wider Greater Cambridgeshire Area, as identified in the Local Plan and Appendix A4;

c) Stream 3

Investment partnerships with third party developers to deliver new homes that will include:

- Acquisition of 3rd party land;
- Include public sector and bank debt
- Incorporation of grants and other funding
- An equal sharing of risk and reward between partners

The investment assessment criteria for all three streams are shown in Appendix A2

3. Financing the Strategy

The Council will fund the 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 prudential borrowing, capital receipts, and reserves and may consider other structures such as joint ventures with pensions and insurance funds. Financing decisions will link to the Council's Financial Strategy and Treasury Management Strategy.

4. Governance Arrangements

It is necessary to have a framework for determining which properties and development opportunities should be invested in.

A dedicated Officer level Property Selection Team (PST) will be formed and structured as outlined in Appendix A3. This team will advise a Property Investment Governance Board (PIGB) on potential purchases and development opportunities that meet the pre-determined selection criteria contained within the Strategy. The PST will identify investment opportunities based on the selection criteria set out in this Strategy, will carry out all necessary due diligence and will present a full business case to the PIGB for challenge.

The structure of the PIGB is also outlined in Appendix A3. The purpose of the PIGB is to challenge and scrutinise investment opportunities identified by the PST, ensuring that only credible options are progressed, and providing the forum for the strategic management of the overall portfolio of investments, consistent with the aims of the Strategy.

The PIGB will be advisory in nature and will assist the Executive Director in his decision making by reviewing, challenging and recommending to him the progression or rejection of property investments.

To enable the timely and decisive decision making which is essential in this type of industry, to respond to opportunities as they arise, regular meetings of the PIGB will be scheduled

Decisions of the Executive Director will be subject to fulfilment of the minimum criteria set out within the Strategy, satisfaction with the business case and risk assessment, and will have regard to the recommendation of the PIGB.

Acquisitions and development opportunities that do not meet the minimum criteria set out within the Strategy may still be considered where they would bring other compelling benefits to the District, but would require approval of Full Council

5. Capacity, Skills and Use of External Advisors

The Guidance requires that elected members and officers involved in the investments decision making process have appropriate capacity, skills and information to enable them to take informed decisions as to whether to enter into a specific investment. 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.

The Council will appoint specialist advisors to provide training to ensure that relevant officers and members have the required skills to make informed decisions and assess the associated risks. This training will take place before any investment decisions associated with the Strategy are considered. The PST will include representatives from Legal Services and Corporate Finance, who will ensure that advisors and officers negotiating deals are aware of the Council’s financial and regulatory frameworks.

The Council recognises that investing in land and properties to generate yield and capital returns is a specialist and potentially complex area. The Council will engage the services of professional property, legal and financial advisors, where appropriate, to access specialist skills and resources to inform the decision-making process associated with this Strategy.

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 and will maintain sufficient in-house expertise to manage the procurement of investments, through the PST.

6. Prudential Indicators

The Guidance requires local authorities to develop quantitative indicators that allow Councillors and the public to assess a local authority's total risk exposure as a result of commercial property investment decisions.

The indicators associated with the Council's proposed Commercial Property Investment Strategy are detailed below.

a. Debt to Net Service Expenditure (NSE) Ratio

This indicator measures the gross debt associated with Commercial Property Investments as a percentage of the Council's net service expenditure, where net service expenditure is a proxy for the size and financial strength of a local authority.

Estimate £'000	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	**Limit**
Gross Debt	-	20,000	40,000	60,000	80,000	100,000	
NSE	18,815	20,701	22,180	21,718	21,177	20,786	
Debt to NSE Ratio	**0%**	**97%**	**180%**	**276%**	**378%**	**481%**	**500%**

The indicator shows that the debt level proposed by the Strategy will be approximately up to 5 times the level of the Council's net revenue budget if the proposed investment in the Strategy is funded solely from borrowing.

Given that the Strategy will take the risk profile of investments into account in the decision-making process and the Council sees property investments as a long-term investment this ratio is reasonable. A maximum limit of 500% has been set for this indicator.

b. Commercial Income to NSE Ratio

This indicator measures the Council's dependence on the income from commercial property investments to deliver core services.

Estimate £'000	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	**Limit**
Commercial income	2,004	2,600	3,200	3,800	4,400	5,000	
NSE	18,815	20,701	22,180	21,718	21,177	20,786	
Commercial income to NSE Ratio	**10.7%**	**12.6%**	**14.4%**	**17.5%**	**20.8%**	**24.1%**	**30%**

The additional income generated from the investments set out within this Strategy will be equivalent to 24% of the Council's Net Service Expenditure by 2023/24. This ratio is considered reasonable and includes the revenues generated from Ermine Street Housing. A maximum limit of 30% has been set for this indicator.

c. Investment Cover Ratio

This indicator measures the total net income from property investments compared to interest expense.

Estimate £'000	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Commercial income	2,004	2,600	3,200	3,800	4,400	5,000
Interest cost	-	594	1,188	1,782	2,376	2,970
Investment cover Ratio	n/a	4.38	2.69	2.13	1.85	1.68

The indicator shows that the net income from property investments is expected to be at least 1.68 times higher than the anticipated interest expense.

d. Loan to Value (LTV) Ratio

This indicator measures the amount of debt compared to the total asset value. In the period immediately after purchase it is normal for the directly attributable costs of purchasing commercial property investments to be greater than the realisable value of the asset (e.g. because of non-value adding costs such as stamp duty). The initially high LTV ratio in 2019/20 is due to the inclusion of the assets of Ermine Street Housing that have been purchased from reserves. A decrease in the loan to value ratio from 2020/21reflects that Debt finance will be raised through Public Works Loan Board borrowings and property values are expected to remain constant, however borrowings will be repaid.

Estimate £'000	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Total debt	-	20,000	40,000	60,000	80,000	100,000
Total asset values	63,553	86,597	128,478	153,509	177,559	201,715
LTV Ratio	-	4.33	3.21	2.56	2.22	2.02

Each year the Council will assess whether assets purchased via the Strategy retain sufficient value to provide security of investment using the fair value model in International Accounting Standard 40: Investment Property. If the fair value of assets is not sufficient to provide security for the capital investment the Strategy will provide detail of the mitigating actions that are being taken, or are proposed to be taken, to protect capital investment.

e. Target Income Returns (Yield)

This indicator shows net revenue income compared to equity and is a measure of achievement of the property portfolio. The net return is shown after making allowance for financing and borrowing repayment costs.

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Target income returns	-	2.5%	2.5%	2.5%	2.5%	2.5%

f. Gross and Net Income

Estimate £'000	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Gross Income:	3,728	5,046	6,509	8,690	9,397	10,107
Net Income	2,004	2,600	3,200	3,800	4,400	5,000

The net income target of £3.2m in 2020/21 to £5M by 2023/24 from Commercial Property Investments is not currently incorporated into the Council's financial projections for the period up to 2023/24. This income will need to be delivered if current service delivery is to be maintained by the Council.

The non-achievement of this income will require the identification of alternative savings proposals, which may result in cuts in service.

The achievement of the target income required from the Strategy will be closely monitored as part of the Council's standard budget monitoring process.

g. Operating Costs

Estimate £'000	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Operating Costs	59	233	259	260	260	260

The above operating costs relate to the cost of the Council's Property Selection Team. The costs shown reflect the cost of managing the procurement of assets under this Commercial Property Investment Strategy and developing the future pipeline of investments

Additional operating costs may be incurred as a result of the purchase of Commercial Investment Properties. Any such costs will be factored into the financial appraisals as part of the purchase assessment to ensure that target net rates of return are achieved. This indicator may therefore be revised once investments are made.

h. Vacancy Levels and Tenant Exposures

This indicator measures and sets targets for the void periods within the property portfolio.

Estimate £'000	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Operating Costs	0%	0%	0%	0%	0%	0%

The target of 0% reflects the strong tenant covenant strengths that will be required under the Stream 1 investment criteria. Void periods will be factored into the financial appraisals as part of the assessment criteria where relevant, therefore this indicator may be revised once investments are made.

Appendix A1

PROPERTY INVESTMENT STREAM 1

1.0 Objective

The objective of the Stream 1 investment criteria is to establish a framework for the identification of commercial property investments which, if acquired, would provide the Council with a positive rental return and capital growth.

The investment criteria are designed to ensure that funds are invested in properties that deliver yield and security commensurate with the Council’s risk appetite.

Each potential investment will be evaluated to ensure the income received is sufficient to provide an acceptable rate of return following the payment of borrowing costs, acquisition costs, management fees and any running costs.

Purchases will take regard of the need to diversify the Council’s property portfolio to manage risks across the entire portfolio.

2.0 Market Analysis and Background

As with other forms of investment at their 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 regions) will deliver long term rental and capital growth with relatively low risk. Prime property in the target regions 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.

The Strategy will adopt the same underlying principle of diversification in acquiring property investments offering a similar return profile. The three main property sectors will be included (industrial, office and retail) and in turn, these will be additionally diversified on criteria including location, the lease term and lot size. When added to the existing portfolio this will assist in protecting the Councils overall risk and return profile should an individual property investment cease to be income producing (for example, it is undergoing refurbishment or awaiting a new tenant).

3.0 Property Acquisition Methodology

Identification, consideration and recommendation of assets suitable for acquisition will be undertaken by a suitably qualified member of Estates and Strategic Land in conjunction with outside specialist guidance and support, procured in accordance with the Council's Contract Procedure Rules.

Estates and Strategic Land and appointed agents will undertake a search of the market which will include approaches and introductions of opportunities direct from the sellers, their agents and third parties.

Introductions from third party agents will be accepted on a first come first serve basis by verbal or written communication to Estates. If after the introduction the Council wishes to pursue the purchase further written agreement on the "basis of engagement" and fees will be required.

The use of independent consultants will be required to assess properties prior to bidding and any purchase will be subject to due diligence on all physical, financial and legal aspects of the property to address its suitability as an asset for long term security and growth.

All investments considered for purchase will undergo qualitative and quantitative appraisal to establish portfolio suitability which will consider rental levels, location, property type, rent review and lease expiry pattern, tenant(s), industry sector, tenure, lease covenants, market exit constraints and physical and environmental factors. In addition, 3rd party advice will be called upon where specialist market knowledge is required.

Property investment markets are, in general, controlled by national and regional commercial property agencies and establishing links and relationships with several such property agents is the best method of sourcing suitable properties for acquisition. Staffing resources will need to be made available to source suitable property assets for acquisition that match the criteria set under the Strategy. This can be done by both recruitment into the existing Estates team and by employing additional external expertise as required.

4.0 Minimum Investment Criteria

For a Stream 1 property investment to be considered by the PIGB for recommendation to the Executive Director it must: -

1. Achieve a minimum weighted score of 100 from the investment criteria matrix shown in Appendix A1.1;
2. Have an initial net yield of 2% after making allowance for financing costs, borrowing repayments and other associated costs;
3. Be accompanied by a full business case prepared by the Property Selection Team.

Each potential property investment will undergo a qualitative and quantitative appraisal and risk assessment to establish portfolio suitability and the legal and financial implications of the purchase. The findings of these appraisals will be reported to the PIGB as part of the business case. Appendix A1.2 details the specific areas that will be included in the business case as a minimum.

All acquisitions, where relevant, will be subject to building and plant survey, independent advice and valuation.

An investment opportunity that does not meet the minimum criteria under investment stream 1 may have separate investment or regeneration benefits and therefore may be considered separately under Stream 2 of the strategy.

5.0 Risk Management

5.1 Financing Risk

As with all investments, there are risks that capital values and rental values can fall as well as rise. To mitigate against future unfavourable market forces, Stream 1 acquisitions will be made on the basis that the Council is willing and capable of holding property investments for the long term i.e. 35 years +. This will ensure income and capital returns are considered over the long term thereby smoothing out any cyclical economic/property downturns.

Where the purchase of a property is reliant on increases in borrowing the business case will factor in fixed rate borrowing costs. By utilising fixed rate borrowing options the Council will be protected from future increases in financing costs.

5.2 Portfolio Risk – void periods

To mitigate the risk of void periods where the property is either partially or fully vacant, or a tenant has defaulted on its rental obligations, the investment portfolio will be actively managed. The investment criteria specified in the scoring matrix will tend to favour secure property investments i.e. high-quality buildings in prime locations, thus mitigating the risk of void periods on re-letting.

Void periods for commercial investment properties acquired under this Strategy will be monitored and vacancy levels will be reported to the PIGB and Audit Committee throughout the year so that they can be actively managed.

6.0 Portfolio Management

Newly purchased property acquired under this Strategy would be added to the existing portfolio and Corporate PPM would undertake asset and property management to maintain and improve the performance of an investment property; or additional specialist resources may need to be bought in as necessary. This would include ensuring statutory and regulatory compliance, tenant compliance, landlord responsibilities, securing receipt of rents, dealing with voids and insurance matters. The costs associated with these areas would be considered in the financial appraisal for the property acquisition.

The property asset management will be subject to an annual review and incorporated within the Property Asset Management Plan (PAM) which is presented to Full Council annually.

APPENDIX A 1.1 Investment Criteria Matrix

The table below shows the suggested scoring criteria to be applied when considering an investment property.

Criteria	excellent	very good	good	marginal	unacceptable
security - break up value	comfortably exceeds investment costs	exceeds investment costs	meets investment costs	below investment costs - good BP match	below investment costs - unacceptable BP match
liquidity- income	£1m+ pa	<£1m >£500k	<£500k >£250k	<£250k >£100k	<£100k
yield	5%+	4-4.99%	2.5-3.99%	>1% - 2.40%	<1%
proportionality - location	prime within district	secondary within district	within GCP area	within TTW area	outside TTW area
proportionality - investment size	£6m- £12m	£4m- £6m £12m-£20m	£2m-£4m £20m-£35m	£1m-£2m £35m-£50m	<£1m - >£50m
Capacity & Skills	100% capacity & skills	75% capacity & skills	50% capacity & skills	25% capacity & skills	<25% capacity & skills

- **Security** – does the investment protect the capital sums invested from loss? Purely commercial investments would be expected to comfortably exceed investment costs, however schemes that scored highly in terms of business plan objectives, may not always meet or exceed initial investment costs.
- **Liquidity –** the income an investment generates is key to delivering returns needed to support the MTFS and protect services.
- **Yield –** the yield will reflect the balance between security and liquidity sought from an investment, with purely commercial investments expecting to return higher yields than those that meet important business plan objectives.
- **location –** the location of the investment is important in that it needs to relate to a Local Plan priority, which may include investments in projects outside of the Council boundary but within the travel to work area.
- **Investment size –** a portfolio of investments of a range of sizes rather than one or two large investments that take up all the investment capacity of the Strategy would enable a more prudential approach to managing risk, as well as providing a balance between commercial return and business plan objectives.
- **Capacity and skills–** the capacity of the Property Selection Team, and therefore the Property Investment Governance Board are a limiting factor. If the resources are not available to pursue a potential investment the Council may need to consider revising the Investment Strategy.

In addition to the above criteria the PIGB and the Executive Director should, when assessing the merits of an investment, specifically consider compatibility with all SCDC policies on matters relating to use such as: -

- Alcohol or tobacco production or sale;
- Animal exploitation;
- Environmentally damaging practices;
- Gambling;
- Pornography.

APPENDIX A1.2 - Stream 1 Business Case

The PST will prepare a business case for Stream 1 investments where the minimum weighted score target has been met. The business case will include the following as a minimum:

a) Financial Appraisal

A detailed financial appraisal setting out the projected income and costs associated with a potential acquisition along with an assessment of the proposed financing options and associated risks and considerations.

b) Lease Classification

A lease should be classified, for accounting purposes, as an operating lease rather than finance lease, to ensure that all rental income can be treated as revenue income (rather than a mix of capital receipt and revenue income). Operating leases are those where the risks and rewards of ownership are retained by the lessor (the Council) and must meet certain criteria. The main criteria being that the lease term should not be for the major part of the property's economic life and at the start of the lease, the total value of minimum lease payments (rents) should not amount to a significant proportion of the value of the property.

c) Risk Management Assessment

A detailed risk assessment of the potential purchase, including but not limited to:

- Specific risks associated with individual assets:
- Tenant default on rental payment (covenant risk)
- Risk of failure to re-let (void risks)
- Costs of ownership and management
- Differing lease structures (e.g. rent review structure, lease breaks).
- Sector risk (portfolio spread)

Market Risks, including risks of structural change or market failure, which may affect the market as a whole or particular subsectors or groups of property:

- Illiquidity upon sale (e.g. lot size, transaction times, availability of finance)
- Failure to meet market rental expectations (forecast rental growth)
- Failure to meet market yield expectations (forecast yield shift)
- Risk of locational, economic, physical and functional depreciation through structural change
- Risks associated with legislative change (e.g. planning or changes in fiscal policy)

d) Portfolio Assessment

An assessment to establish suitability against the Council's existing property portfolio which will consider rental levels, location, property type, rent review and lease expiry patterns, industry sector, tenure, lease covenants, market exit constraints and physical and environmental factors.

e) Report on Title

To confirm ownership.

APPENDIX A2 - PROPERTY INVESTMENT STREAM 2

1. Objective

The objective of the Stream 2 investment criteria is to establish a framework for the identification of properties or land for redevelopment. These opportunities may deliver placemaking or economic development benefits, as defined in the Councils Business Plan, **as well as** positive financial returns for the Council in the form of future revenue income streams or capital uplifts. Future revenue income streams could include increases in retained business rates income and New Homes Bonus.

Developed properties may be retained for the benefit of their long-term rental income and will become an investment asset after completion.

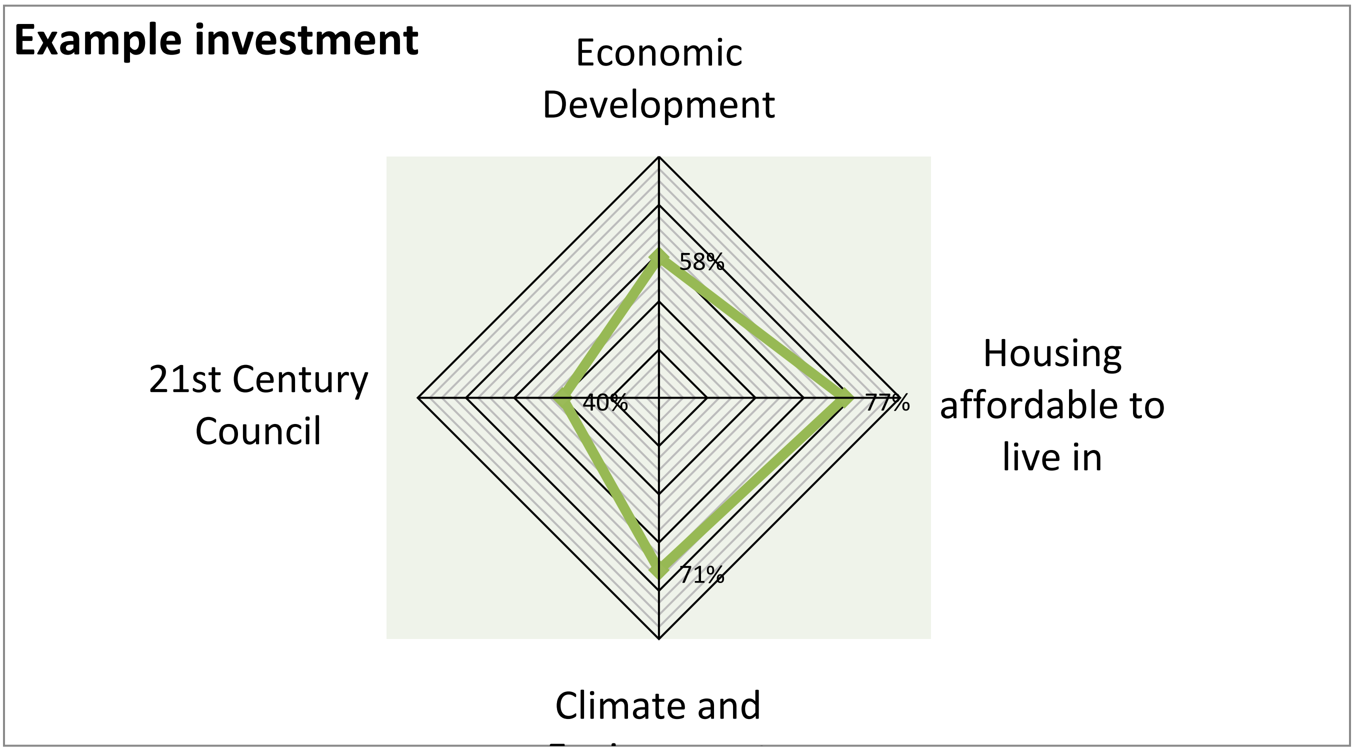
The Stream 2 investment criteria will be designed to ensure that the financial returns delivered from investments are commensurate with the deemed levels of associated risk. A higher risk investment will therefore require the delivery of greater financial returns.

2. Business plan objectives

In addition to financial indicators, Stream 2 investments will be assessed for their strategic fit against the focus areas contained within the 2019-24 Business Plan.

Example fit with Business Plan objectives

Business Plan areas:	score
Economic Development	58%
Housing affordable to live in	77%
Climate and Environment	71%
21st Century Council	40%
% fit with business plan	**62%**



3. Market Analysis and Background

Stream 2 investment opportunities could come in a diverse range of forms. Examples include, but are not limited to:

- Investing in climate and environmental initiatives
- Investing in Social Capital
- Redeveloping Council owned assets;
- Building homes and commercial premises;
- Using public land and buildings to achieve long term socio economic development within the District and wider Greater Cambridgeshire Area, as identified in the Local Plan and Appendix A4;

As with other forms of investment there is a trade-off between risk and return. Given the more speculative nature of this type of investment activity the risks associated with this type of investment may, in some cases, be higher than those associated with Stream 1 activity. It may be possible to share risks and rewards of Stream 2 activities with adjoining councils and other public sector and private sector partners.

The assessment criteria for Stream 2 activities needs to be agile enough to allow significantly different schemes to be assessed using the same overarching principles.

4. Minimum Investment Criteria

For a Stream 2 property investment to be considered by the PIGB and the Executive Director it must: -

1. Deliver a rate of return commensurate with the deemed level of risk associated with the investment;
2. Be accompanied by a full business case prepared by the Property Selection Team, and other officers where relevant.

The investment opportunities considered under Stream 2 could vary significantly and, due to the speculative nature of some schemes, there will be higher risks attached to some investment opportunities.

The minimum net rate of return for a low risk Stream 2 investment would be the 2% required to deliver the savings attached to the Investment Strategy, after making allowance for financing costs and borrowing repayment costs. A high-risk scheme, for example, may be required to achieve a return of up to 20%.

Each potential Stream 2 investment will undergo a qualitative and quantitative appraisal and risk assessment to establish the financial returns, financial and legal implications and risks associated with the purchase. The findings of these appraisals will be reported to the PIGB as part of the business case.

An investment opportunity that does not meet the minimum criteria under investment stream 2 may have separate investment or regeneration benefits and therefore may still be considered for progression however decision making in this case is to be reserved to the Leader of the Council rather than the Executive Director.

5. Acquisition / Development Methodology

Identification, consideration and recommendation of assets suitable for acquisition and / or development will be undertaken by a suitably qualified member of Estates and Strategic Land in conjunction with internal and external specialist guidance and support.

All investments considered for purchase will undergo qualitative and quantitative appraisals to establish financial suitability and risks. In addition, 3rd party advice will be called upon where specialist market knowledge is required.

6. Risk Management

Financing Risk
As with all investments, there are risks that capital values, rental values and development values can fall as well as rise. Where the acquisition or development is reliant on increases in borrowing the business case will factor in fixed rate borrowing costs commensurate with the anticipated holding period of the asset. By utilising fixed rate borrowing options the Council will be protected from future increases in financing costs.

Financial returns from Stream 2 activities may come in the form of capital receipts rather than revenue returns. This would need to be considered carefully as part of the overall Strategy given the requirement to achieve net revenue returns of 2.5% from the investment strategy overall. The returns linked with this Strategy will be carefully managed and monitored as part of the Council's budget monitoring framework and there will be clear links between this Strategy and the Financial Strategy.

APPENDIX A3 - PROPERTY INVESTMENT STREAM 3

1.0 Objective

The objective of the Stream 3 investment criteria is to establish a framework for the identification of properties or land for development of new homes through Investment Partnerships. These opportunities may deliver regeneration or economic development benefits as well as positive financial returns for the Council in the form of future revenue income streams or capital uplifts. Future revenue income streams will include:

- Rental income from Council Housing (HRA Affordable Homes);
- Rental income from Private Rented Sector Housing (PRS) through Ermine Street Housing;
- Capital receipts from Intermediate Home Ownership staircasing;
- Capital receipts from Right to Buy;
- Increases in retained business rates;
- Income and New Homes Bonus.

Developed properties may be retained for the benefit of their long-term rental income and will become an investment asset after completion.

The Stream 3 investment criteria will be designed to ensure that the financial returns delivered from investments are commensurate with the deemed levels of associated risk. A higher risk investment will therefore require the delivery of greater financial returns.

2.0 Market Analysis and Background

Stream 3 investment partnerships could come in a diverse range of forms. Examples include, but are not limited to:

- Building homes and commercial premises;
- Using public land and buildings to achieve long term socio economic sustainability for the District and wider Greater Cambridgeshire Area, as identified in the Local Plan and Appendix A4.

As with other forms of investment there is a trade-off between risk and return. Given the more speculative nature of this type of investment activity the risks associated with this type of investment may, in some cases, be higher than those associated with Stream 1 activity. It will be possible to share risks and rewards of stream 3 activities with investment partners.

The assessment criteria for Stream 3 activities needs to be agile enough to allow significantly different schemes to be assessed using the same overarching principles.

3.0 Minimum Investment Criteria

For a Stream 3 property investment to be considered by the PIGB it must: -

- Deliver a rate of return commensurate with the deemed level of risk associated with the investment;
- Be accompanied by a full business case prepared by the Property Selection Team, and other officers where relevant.

The scoring matrix for Stream 3 investments will be based on the target rates of return for Stream 2 investments. Schemes with higher risks will be expected to deliver higher levels of return to cover the risk considerations, and only schemes that deliver the assessed rate of return will pass the minimum assessment criteria.

The minimum net rate of return for a low risk Stream 3 investment would be the 2% required to deliver the savings attached to the Investment Strategy, after making allowance for financing costs and borrowing repayment costs.

Each potential Stream 3 investment will undergo a qualitative and quantitative appraisal and risk assessment to establish the financial returns, financial and legal implications and risks associated with the purchase. The findings of these appraisals will be reported to the PIGB as part of the business case.

An investment opportunity that does not meet the minimum criteria under investment stream 3 may have separate investment or regeneration benefits and therefore may still be considered for progression however decision making in this case is to be reserved to the Full Council rather than the PIGB.

4.0 Acquisition / Development Methodology

Identification, consideration and recommendation of assets suitable for acquisition and / or development will be undertaken by the Property Selection Team in conjunction with internal and external specialist guidance and support.

All investments considered for purchase will undergo qualitative and quantitative appraisals to establish financial suitability and risks. In addition, 3rd party advice will be called upon where specialist market knowledge is required.

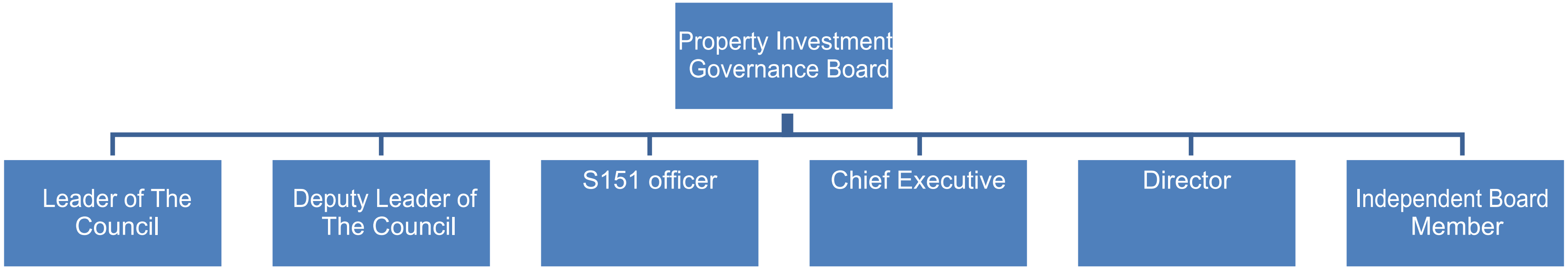
5.0 Risk Management

Financing Risk
As with all investments, there are risks that capital values, rental values and development values can fall as well as rise. Where the acquisition or development is reliant on increases in borrowing the business case will factor in fixed rate borrowing costs commensurate with the anticipated holding period of the asset. By utilising fixed rate borrowing options the Council will be protected from future increases in financing costs.

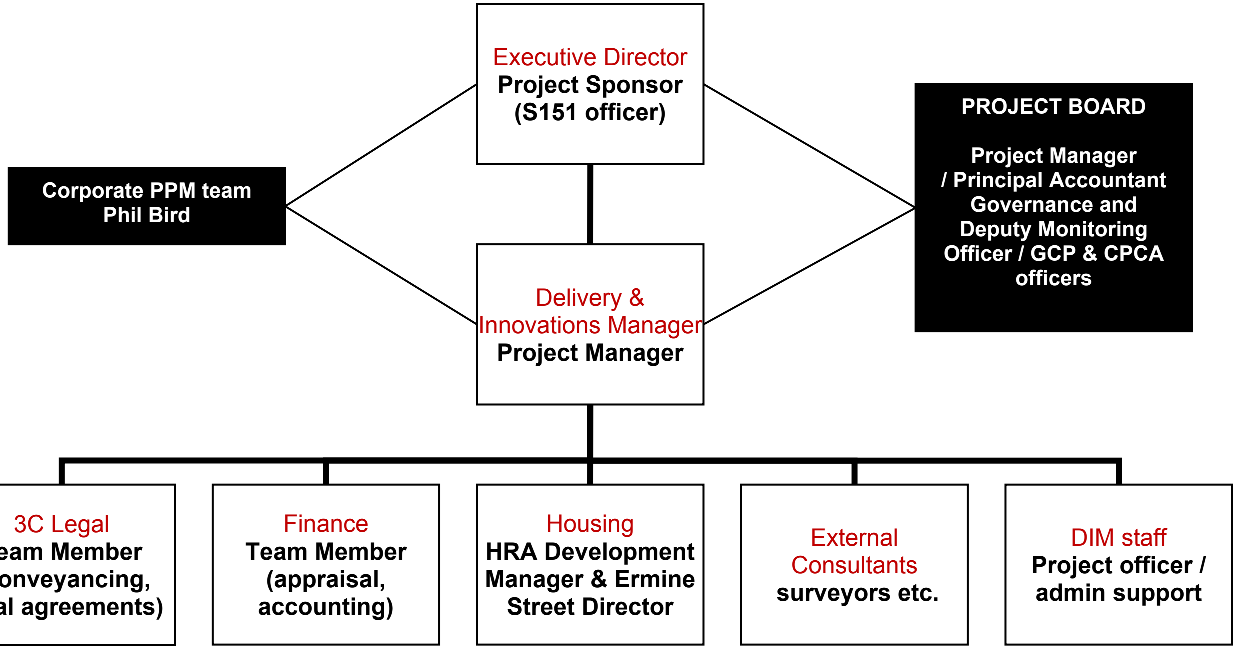
Financial returns from Stream 3 activities may come in the form of capital receipts rather than revenue returns. This would need to be considered carefully as part of the overall Strategy given the requirement to achieve net revenue returns of 2% from the investment. The returns linked with this Strategy will be carefully managed and monitored as part of the Council's budget monitoring framework and there will be clear links between this Strategy and the Financial Strategy.

APPENDIX A3

PROPERTY INVESTMENT GOVERNANCE BOARD (PIGB) STRUCTURE



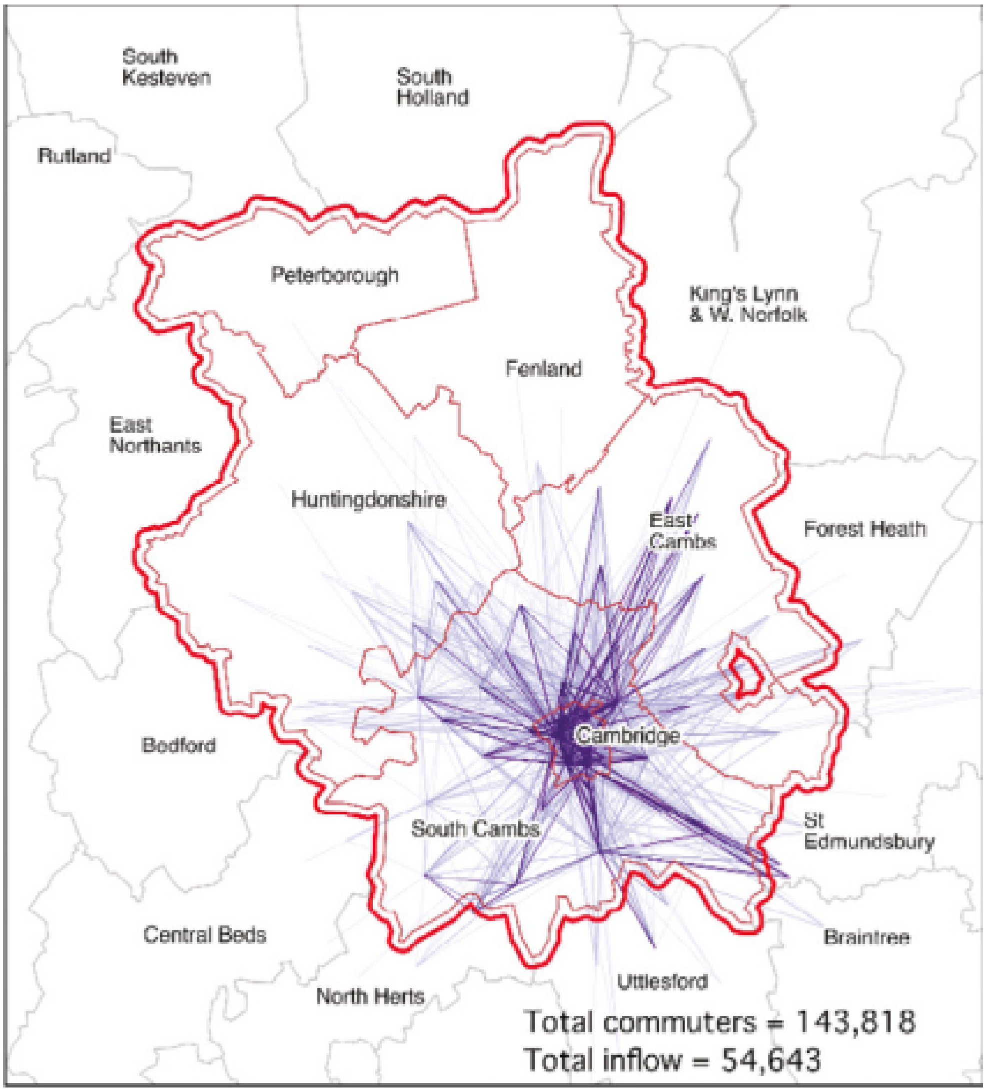
PROPERTY SELECTION TEAM (PST) STRUCTURE



APPENDIX A4

Investment Target Area

The investment target area outside of the Local Plan boundary follows the definition of the Greater Cambridge commuting pattern, as identified in the Cambridgeshire and Peterborough Independent Economic Review (September 2018)



Appendix 4

Treasury Management Strategy Statement 2019-20 to 2021-22

1. Executive Summary

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

1.2 The first and most important is the Treasury Management Strategy Statement (this report) incorporating prudential and treasury indicators which covers:

- Capital plans (including prudential indicators)
- A Minimum Revenue Provision policy which explains how unfinanced capital expenditure will be charged to revenue over time;
- The Treasury Management Strategy (how investments and borrowings are to be organised) including treasury indicators; and

1.3 A mid-year treasury management report is produced to update members on the progress of the capital position, amending prudential indicators as necessary and to advise if any policies require revision.

1.4 The outturn or annual report compares actual performance to the estimates in the Strategy.

1.5 The statutory framework for the prudential system under which local government operates is set out in the Local Government Act 2003 and Capital Financing and Accounting Statutory Instruments. The framework incorporates four statutory codes. These are:

- The Prudential Code prepared by CIPFA
- The Treasury Management Code prepared by CIPFA
- The Statutory Guidance on Local Authority Investments prepared by Ministry of Housing, Communities and Local Government (MHCLG)
- The Statutory Guidance on Minimum Revenue Provision prepared by MHCLG

1.6 CIPFA have published a revised Prudential Code (2017 edition) with accompanying Guidance Notes for Practitioners (2018 edition) and the Treasury Management Code (2017 edition).

1.7 The MHCLG have also published a revised Investment Guidance and Minimum Revenue Provision Guidance (both commenced on 1st April 2018). This report therefore reflects the new requirements. The most notable change is the requirement to expand the Investment Strategy to non-financial assets such as investments in property.

1.8 The council's S151 Officer has considered the deliverability, affordability and risk associated with the council's capital expenditure plans and treasury management activities. The plans are affordable and where there are risks such as the slippage of capital expenditure or reductions in income or value from investments these have been considered and are mitigated or at an acceptable level. The council has access to specialist advice where appropriate.

1.9 Treasury management reports are required to be adequately scrutinised before being recommended to Council. The Treasury Management Strategy is scrutinised by the Overview and Scrutiny Committee alongside the council's budget papers each year. Scrutiny and approval of the half year and outturn reports is delegated to the Audit and Corporate Governance Committee.

2. Recommendations

Council is asked to approve:

2.1 This report, including the estimated Prudential & Treasury Indicators for 2019/20 to 2021/22, inclusive, as set out in Appendix C;

2.2 To increase the upper limit of investment in Ermine Street Housing (ESH) to £64.561m in 2018/19, £76.068m in 2019/20 and £88.757m in 2020/21 in line with the current ESH business plan. This lending will be supported by external borrowing to the extent necessary to maintain a minimum £20m working cash balance (i.e. total investment balance less loans to Ermine Street Housing);

2.4 To set the council's operational boundary and authorised borrowing limit for external debt in relation to its need to borrow (as expressed by the Capital Financing Requirement), being £5m and £10m respectively over this amount.

3. Background

3.1 Treasury Management Activities

3.2 The council is required to comply with the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice. The council is required to set prudential and treasury indicators, including an authorised limit for borrowing, for a three-year period and should ensure that its capital plans are affordable, prudent and sustainable. The council also follows MHCLG Investment Guidance.

3.3 The council contracted with Link Asset Services during 2018/19 to provide treasury management advice on developments and best practice in this area and information on the creditworthiness of potential counterparties, deposit and borrowing interest rates and the economy.

4. Borrowing Policy Statement

4.1 The Council is permitted to borrow under the Prudential Framework, introduced with effect from 1st April 2004.

4.2 At present the only debt held by the authority relates to the 41 loans from the PWLB for self-financing the HRA taken out in 2012 totalling £205,123,000.

4.3 The council does anticipate that there may be some external borrowing for the period 2019/20 to 2021/22, inclusive. Hence the recommendation above to increase the council's external authorised borrowing Limit.

4.4 In the event that external borrowing is undertaken the council is able as an eligible local authority to access funds at the PWLB Certainty Rate (a 0.20% discount on loans) until 31st October 2019.

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

5. Minimum Revenue Provision (MRP) Policy Statement

5.1 Minimum Revenue Provision (MRP) is the revenue charge that the council is required to make for the repayment of debt, as measured by the underlying need to borrow, rather than actual debt. The underlying debt is needed to finance capital expenditure which has not been fully financed by revenue or capital resources. As capital expenditure is generally expenditure on assets which have a life expectancy of over one year it is prudent to charge an amount for the repayment of debt over the life of the asset or some similar proxy figure.

5.2 The Local Authorities (Capital Finance and Accounting) regulations require local authorities to calculate for the financial year an amount of MRP which is considered to be 'prudent'.

5.3 There is no requirement to charge MRP where the Capital Financing Requirement (CFR) is nil or negative at the end of the preceding financial year.

5.4 The Housing Revenue Account share of the CFR is not subject to an MRP charge.

5.5 There is no requirement to make a MRP charge on an asset until the financial year after that asset becomes operational.

5.6 The Government has issued revised guidance (issued in January 2018) on the calculation of MRP. The council is required to have regard to the guidance based on the underlying principle that the provision should be linked to the life of the assets for which the borrowing is required.

5.7 However, the guidance is clear that differing approaches can be considered if the resulting provision is prudent.

5.8 In general, the council will make a minimum revenue provision based on the equal instalment method, amortising expenditure equally over the estimated useful life of the asset for which the borrowing is required. However, no provision will be made in respect of expenditure on specific projects where the Chief Financial Officer determines that receipts will be generated by the project to repay the debt.

5.9 Where a loan is made to a wholly owned subsidiary of the council, the loan is deemed to be secured on the assets of the company. Evidence of the ability to repay the loan will be based on the company's business plan and asset valuation, and no minimum revenue provision will be made. The council will review the loan and business plan annually, where there is evidence that suggests the full amount of the loan will not be repaid it will be necessary to reassess the charge to recover the impaired amounts from revenue.

5.10 Exceptionally, where capital expenditure is part of a loan agreement to other than a wholly owned subsidiary, the council may register a fixed and floating charge over the counterparty assets to secure the council's interest in the investment, or alternately an equity share interest in an asset with value.

5.9 The council is considering a programme of investment in commercial property using powers under S12 of the Local Government Act 2003. This is deemed capital expenditure and will be financed from cash balances and/or external borrowing as appropriate at the time. MRP will be provided for using the useful life determinant with regard to maximum lives permitted in the revised MHCLG MRP guidance of 50 years for freehold land and 40 years for all other assets. MRP will be made on the purchase of these properties from the date that rental income is earned.

6. The council's Capital Expenditure and Financing 2018/19 to 2021/22

6.1 The council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, developer contributions, revenue contributions, reserves etc.), which has no resultant impact on the council's borrowing need; or;
- If insufficient financing is available, or a decision is taken not to apply other resources, the funding of capital expenditure will give rise to a borrowing need.

6.2 Details of capital expenditure forms one of the required prudential indicators. The table below shows the proposed capital expenditure and how it will be financed.

Table 1 – Capital expenditure and financing

£'000	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Capital expenditure					
General Fund	4,436	4,051	3,416	7,746	3,332
HRA	16,972	18,637	27,031	35,851	21,947
Third party loans - ESH	19,853	28,055	12,507	12,689	-
Third party loans - Other	-	2,400	-	-	-
Total capital expenditure	**41,261**	**53,143**	**42,954**	**56,286**	**25,279**
Resourced by:					
Capital receipts	(1,417)	(4,718)	(6,796)	(8,822)	(5,066)
Other contributions	(18,630)	(17,125)	(23,651)	(34,561)	(19,625)
Total available resources for financing capital expenditure	**(20,047)**	**(21,843)**	**(30,447)**	**(43,383)**	**(24,691)**
Un-financed capital expenditure	**21,214**	**31,300**	**12,507**	**12,903**	**588**

7. The council's Prudential and Treasury Management Indicators

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

Table 2 - Capital Financing Requirement and cumulative external borrowing

£'000	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
CFR as at 1st April					
- General Fund	20,938	41,680	72,264	84,015	96,119
- HRA	204,429	204,429	204,429	204,429	204,429
Total	**225,367**	**246,109**	**276,693**	**288,444**	**300,548**
Un-financed capital expenditure	21,214	31,301	12,507	12,903	588
Minimum Revenue Provision (MRP)	(472)	(717)	(756)	(799)	(689)
CFR as at 31st March	**246,109**	**276,693**	**288,444**	**300,548**	**300,447**
Movement in CFR	**20,742**	**30,584**	**11,751**	**12,104**	**(101)**
Estimated external gross debt / borrowing (including HRA reform)	205,123	205,123	217,630	230,319	230,319
Authorised limit for external debt	249,100	286,693	298,444	310,548	310,447
Operational boundary for external debt	249,100	281,693	293,444	305,548	305,447

7.2 During the above financial years the Council will operate within the 'authorised' and 'operational' borrowing limits contained within the Prudential Indicators set out in the Council's Treasury Management Strategy Statement. The anticipated Prudential & Treasury indicators are shown in Appendix C.

7.3 It is recommend that, from 2018/19 onwards, the authorised limit and operational boundary for external debt are set with reference to the estimated CFR, to ensure that the council has sufficient approved borrowing capacity, if needed.

8. Investment Strategy

8.1 The Council's overall approach to investment in financial and non-financial assets is outlined in the Capital and Investment Strategies presented in a separate report to this Committee.

Financial Asset Counterparties

8.2 The full listing of approved counterparties is presented at Appendix A, showing the category under which, the counterparty has been approved, the appropriate deposit limit and current duration limits.

8.3 The Council's loans as at 31 March 2018 and 30 September 2018 were as follows: -

	2017/18		2018/19	
	Actual as at 31 March 2018		Actual as at 30 September 2018	
	£m	Rate %	£m	Rate %
Loans:				
Local authorities	4.00	0.83	9.00	0.83
Clearing banks	20.50	0.71	27.00	0.90
Other banks	5.00	0.87	5.00	1.11
Housing Associations	5.00	1.25	5.00	1.25
Money Market Funds	3.43	0.46	1.62	0.67
Building Societies with assets:				
- Greater than £10bn	8.00	0.76	16.50	0.77
- Between £5bn and £10bn	0.00			
- Between £1.5bn and £5bn	0.00			
Shares	0.05		0.05	
Ermine Street - South Cambs Ltd	35.50	3.74	49.08	3.78
Other Investments				
Total Loans	**81.48**		**113.25**	

8.4 **Loan security**

The Chief Financial Officer will review at least annually the list of approved organisations and make appropriate amendments to individual organisations on the list, but not to the principles on which it is compiled without the approval of the cabinet.

9. Brexit Update

9.1 At the time of writing this report there is still considerable uncertainly around the country's proposed exit from the EU on 29 March 2019, following the cancellation of the parliamentary vote on 11 December 2018. This is currently now scheduled for the week commencing 14 January 2019.

9.2 The council will continue to monitor the situation and to take advice from treasury advisors as appropriate.

10. Money Market Fund (MMF) Reforms

10.1 The Money Market Fund Regulation came into force on 21st July 2018 which impacts immediately on any new funds created. Existing funds will have to be compliant by no later than 21st January 2019.

10.2 The above Regulation provides investors with a new way of categorising a MMF depending on the level of risk, which could cause fluctuations in their capital values. All the MMFs that the Council uses will be converted from a Constant Net Asset Value (CNAV) to a Low Volatility Net Asset Value (LVNAV) on a month by month basis up to the compliant date of 21st January 2019. In practice, little practical impact has been seen, so no changes are recommended in the investment strategy in relation to these funds.

11. Interest Rates & Interest Received

11.1 Link Asset Services is the Council's independent treasury advisor. In support of effective forecasting the Council needs to be aware of the potential influence of interest rates on treasury management issues for the Council. Link's opinion on interest rates is presented at Appendix B.

11.2 Total interest and dividends of £917,585 has been received on the Council's deposits up to 30th November 2018 (for this financial year) at an average rate of 1.30% (1.06% in 2017/18). This is an under-achievement compared with the budget to date of £108,655, as interest rates have been lower than had been anticipated.

11.3 The Bank of England's Monetary Policy Committee decided to increase its Base Rate by 0.25% to 0.75%, on 2nd August 2018. This is reflected within Link's interest rate predictions at Appendix B.

12. Implications

Financial Implications

The prudential and treasury indicators have been amended to take account of known financial activities.

Risk management

Treasury risks are managed through compliance with the investment strategy and consideration of Security, Liquidity and Yield, in that order, when assessing potential treasury investments.

13. Consultation responses

13.1 None required.

14. Background papers

No background papers were used in the preparation of this report.

15. Appendices

15.1 Appendix A – The Council's current counterparty list
Appendix B – Link's opinion on UK forecast interest rates
Appendix C – Prudential and Treasury Management Indicators
Appendix D – Glossary of Terms and Abbreviations

Background Papers
Where the Local Authorities (Executive Arrangements) (Meetings and Access to Information) (England) Regulations 2012 require documents to be open to inspection by members of the public, they must be available for inspection: -

(a) at all reasonable hours at the offices of South Cambridgeshire District Council;
(b) on the Council's website; and
(c) in the case of documents to be available for inspection pursuant to regulation 15, on payment of a reasonable fee required by the Council by the person seeking to inspect the documents at the offices of South Cambridgeshire District Council.

No background papers were used in the preparation of this report

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Appendix A

Current Counterparty List

The full listing of approved counterparties is shown below, showing the category under which the counterparty has been approved, the appropriate deposit limit and current duration limits. These counterparties have also been shown under Specified and Non-Specified Investments (in line with MHCLG Guidance).

Name	Council's Current Deposit Period	Category	Limit (£)
Specified Investments: -			
All UK Local Authorities	N/A	Local Authority	10m
All UK Police Authorities	N/A	Police Authority	10m
All UK Fire Authorities	N/A	Fire Authority	10m
Debt Management Account Deposit Facility	N/A	DMADF	Unlimited
Barclays Bank Plc	Using Credit Criteria Chart	UK Bank	10m
HSBC Bank Plc	Using Credit Criteria Chart	UK Bank	10m
Lloyds Bank Plc	Using Credit Criteria Chart	UK Bank	10m
Santander UK Plc	Using Credit Criteria Chart	UK Bank	10m
Other UK Retail & Clearing Banks	Using Credit Criteria Chart	UK Banks	10m
Subsidiaries of UK Banks (provided the subsidiaries are UK-incorporated deposit takers under the Financial Services and Markets Act 2000 and provided loans are for a maximum period of three months)	Using Credit Criteria Chart	UK Banks	£3m
Places for People Homes Ltd	Using Credit Criteria Chart	Registered Housing Association	5m
Close Brothers Ltd	Using Credit Criteria Chart	UK Retail Bank	5m
Money Market Funds: HSBC GLF MMF Aberdeen Standard Life Deutsche GLS Barclays Call Account	Liquid Rolling Balance	Financial Instrument	10m (per fund)

<table>
<tr><th>Name</th><th>Council's Current Deposit Period</th><th>Society Asset Value (£'m) – as at 1st May 2018</th><th>Limit (£)</th></tr>
<tr><td colspan="4">Other Specified Investments - UK Building Societies: -</td></tr>
<tr><td>Nationwide Building Society</td><td rowspan="7">Deposit period: Using Credit Criteria chart below</td><td>221,670</td><td rowspan="7">Assets greater than £10,000m
Limit - £10m

Assets between £10,000m and £5,000m
Limit - £5m

Assets between £5,000m and £1,500m
Limit - £3m</td></tr>
<tr><td>Yorkshire Building Society</td><td>42,047</td></tr>
<tr><td>Coventry Building Society</td><td>42,573</td></tr>
<tr><td>Skipton Building Society</td><td>21,024</td></tr>
<tr><td>Leeds Building Society</td><td>18,484</td></tr>
<tr><td>Principality Building Society</td><td>9,263</td></tr>
<tr><td>Nottingham Building Society</td><td>3,988
(Jun 2018)</td></tr>
<tr><th>Name</th><th>Council's Current Deposit Period</th><th>Category</th><th>Limit (£)</th></tr>
<tr><td colspan="4">Non-Specified Investments: -</td></tr>
<tr><td>All UK Local Authorities – longer term limit</td><td>Over 1 year and up to 5 years</td><td>Local Authority</td><td>10m per single counterparty</td></tr>
<tr><td>CCLA Local Authorities' Property Fund</td><td>Minimum of 5 years</td><td>Pooled UK Property Fund</td><td>Up to 10m</td></tr>
<tr><td>South Cambs Ltd - Housing Co.</td><td>Up to 5 years</td><td>Loan</td><td>107m</td></tr>
<tr><td>UK Municipal Bonds Agency</td><td>N/A</td><td>Share Capital</td><td>0.050m</td></tr>
</table>

	Grading (for the purpose of standardisation)	Fitch		Moody's		Standard & Poor's		
		Long Term	Short Term less than or equal to one year	Long Term	Short Term less than or equal to one year	Long Term	Short Term less than or equal to one year	
Investment Grade	Extremely strong Grade	AAA	F1+	Aaa	P-1	AAA	A-1+	SCDC Investment Criteria
	Very Strong Grade	AA+	F1+	Aa1	P-1	AA+	A-1+	
		AA	F1+	Aa2	P-1	AA	A-1+	
		AA-	F1+	Aa3	P-1	AA-	A-1+	
	Strong, but susceptible to adverse conditions grade (strong grade)	A+	F1+ F1	A1	P-1	A+	A-1+ A-1	
		A	F1	A2	P-1 P-2	A	A-1+	
		A-	F1 F2	A3	P-1 P-2	A-	A-1+ A-2	
	Adequate grade	BBB+	F2	Baa1	P-2	BBB+	A-2	
		BBB	F2 F3	Baa2	P-2 P-3	BBB	A-2 A-3	
		BBB-	F3	Baa3	P-3	BBB-	A-3	
Sub-investing Grade	Speculative grade	BB+	B	Ba1	Not Prime (NP)	BB+	B-1	
		BB	B	Ba2	NP	BB	B-2	
		BB-	B	Ba3	NP	BB-	B-3	
	Very speculative grade	B+	B	B1	NP	B+	-	
		B	B	B2	NP	B	-	
		B-	B	B3	NP	B-	-	
	Vulnerable grade	CCC	C	Caa1	NP	CCC+	C	
		CCC	C	Caa2	NP	CCC	C	
		CCC	C	Caa3	NP	CCC-	C	
		CC	C	-	NP	CC	C	
		C	C	Ca	NP	C	C	
	Defaulting grade	D	D	C	NP	D	D	

Link Asset Services - Prospects for interest rates

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

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

The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth has been healthy since that meeting but is expected to weaken somewhat during the last quarter of 2018. At their November meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. The next increase in Bank Rate is therefore forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed funds rate to reach 2.00 – 2.25% in September 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We therefore saw US 10 year Treasury yields rise above 3.2% during October 2018 and also saw investors causing a sharp fall in equity prices as they sold riskier assets.

Rising bond yields in the US have also caused some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure has been dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

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

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

Investment and borrowing rates

- Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.
- Borrowing interest rates have been volatile so far in 2018-19 and have increased modestly since the summer. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;

Appendix C

PRUDENTIAL & TREASURY MANAGEMENT INDICATORS

£'000	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
PRUDENTIAL INDICATORS					
Capital expenditure					
General Fund	4,436	4,051	3,416	7,746	3,332
HRA	16,972	18,637	27,031	35,851	21,947
Third party loans - ESH	19,853	28,055	12,507	12,689	-
Third party loans - Other	-	2,400	-	-	-
Total capital expenditure	**41,261**	**53,143**	**42,954**	**56,286**	**25,279**
Capital Financing Requirement (CFR) as at 31 March					
- General Fund	20,938	41,680	72,264	84,015	96,119
- HRA	204,429	204,429	204,429	204,429	204,429
Total	**225,367**	**246,109**	**276,693**	**288,444**	**300,548**
Change in CFR	**20,742**	**30,584**	**11,751**	**12,014**	**(101)**
Deposits at 31 March	**81,431**	**85,000**	**70,000**	**60,000**	**50,000**
External Gross Debt	**205,123**	**205,123**	**217,630**	**230,319**	**230,319**
Ratio of financing costs to net revenue stream					
- General Fund	**-2%**	**-2%**	**-2%**	**-1%**	**-1%**
- HRA	**24%**	**24%**	**24%**	**24%**	**24%**
Total (%)	**22%**	**22%**	**22%**	**23%**	**23%**

PRUDENTIAL & TREASURY MANAGEMENT INDICATORS

£'000	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
TREASURY INDICATORS					
Authorised limit					
for borrowing	249,100	286,693	298,444	310,548	310,447
for other long-term liabilities	0	0	0	0	0
Total	**249,100**	**286,693**	**298,444**	**310,548**	**310,447**
HRA Debt Limit	205,123	205,123	205,123	205,123	205,123
Operational boundary					
for borrowing	249,100	281,693	293,444	305,548	305,447
for other long-term liabilities	0	0	0	0	0
Total	**249,100**	**281,693**	**293,444**	**305,548**	**305,447**
Upper limit for total principal sums deposited for over 364 days	**41,000**	**70,000**	**80,000**	**95,000**	**95,000**
Maturity structure of new fixed rate borrowing		Upper Limit	Lower Limit		
10 years and above		100%	0%		

Treasury Management – Glossary of Terms and Abbreviations

Term	Definition
Authorised Limit for External Borrowing	Represents a control on the maximum level of borrowing
Capital Expenditure	Expenditure capitalised in accordance with regulations i.e. material expenditure either by Government Directive or on capital assets, such as land and buildings, owned by the Council (as opposed to revenue expenditure which is on day to day items including employees' pay, premises costs and supplies and services)
Capital Financing Requirement	A measure of the Council's underlying borrowing need i.e. it represents the total historical outstanding capital expenditure which has not been paid for from either revenue or capital resources
Certificates of Deposit (CDs)	Low risk certificates issued by banks which offer a higher rate of return
CIPFA	Chartered Institute of Public Finance and Accountancy
Corporate Bonds	Financial instruments issued by corporations
Counterparties	Financial Institutions with which funds may be placed
Credit Risk	Risk of borrower defaulting on any type of debt by failing to make payments which it is obligated to do
MHCLG	Ministry for Housing, Communities & Local Government (formerly the Department for Communities & Local Government, DCLG)
Enhanced Cash Funds	Higher yielding funds typically for investments exceeding 3 months
Eurocurrency	Currency deposited by national governments or corporations in banks outside of their home market
External Gross Debt	Long-term liabilities including Private Finance Initiatives and Finance Leases
Government CNAV	Highly liquid sovereign stock based on a Constant Net Asset Value (CNAV)
HRA	Housing Revenue Account - a 'ring-fenced' account for local authority housing account where a council acts as landlord
HRA Self-Financing	A new funding regime for the HRA introduced in place of the previous annual subsidy system
London Interbank Offered Rate (LIBOR)	A benchmark rate that some of the leading banks charge each other for short-term loans
London Interbank Bid Rate (LIBID)	The average interest rate which major London banks borrow Eurocurrency deposits from other banks
Liquidity	A measure of how readily available a deposit is
MPC	Monetary Policy Committee - The Bank of England Committee responsible for setting the UK's bank base rate
Low Volatility Net Asset Value (LVNAV)	Highly liquid sovereign stock based on a Constant Net Asset Value (CNAV)

Term	Definition
Non-Ring-Fenced Bank (NRFB)	Government & Bank of England rules will apply to all UK Banks which have to split their business into ‘core’ retail and investment units known as Ring and Non-Ring-Fenced Banks for the 1st January 2019 deadline
Non-Specified Investments	These are investments that do not meet the conditions laid down for Specified Investments and potentially carry additional risk, e.g. lending for periods beyond 1 year
Operational Boundary	Limit which external borrowing is not normally expected to exceed
PWLB	Public Works Loans Board - an Executive Government Agency of HM Treasury from which local authorities & other prescribed bodies may borrow at favourable interest rates
Ring Fenced Bank (RFB)	Government & Bank of England rules will apply to all UK Banks which have to split their business into ‘core’ retail and investment units known as Ring and Non-Ring-Fenced Banks for the 1st January 2019 deadline
Security	A measure of the creditworthiness of a counter-party
Specified Investments	Those investments identified as offering high security and liquidity. They are also sterling denominated, with maturities up to a maximum of 1 year, meeting the minimum ‘high’ credit rating criteria where applicable
Supranational Bonds	Multi-lateral Development Bank Bond
UK Government Gilts	Longer-term Government securities with maturities over 6 months and up to 30 years
Variable Net Asset Value (VNAV)	MMFs values based on daily market fluctuations to 2 decimal places known as mark-to-market prices
UK Government Treasury Bills	Short-term securities with a maximum maturity of 6 months issued by HM Treasury
Weighted Average Life (WAL)	Weighted average length of time of unpaid principal
Weighted Average Maturity (WAM)	Weighted average amount of time to maturity
Yield	Interest, or rate of return, on an investment