Public Document Pack

AUDIT COMMITTEE
Thursday 2 February 2023
2.00 pm Luttrell Room - County Hall, Taunton

To: The members of the Audit Committee

Cllr D Ruddle (Chair), Cllr A Sully (Vice-Chair), Cllr Cllr L Baker, Cllr S Carswell, Cllr M Caswell, Cllr N Cavill, Cllr M Chilcott, Cllr P Clayton, Cllr S Coles, Cllr H Davies, Cllr H Farbahi, Cllr T Kerley, Cllr M Lewis and Whitten

All Somerset County Council Members are invited to attend.

Issued By Scott Wooldridge, Strategic Manager - Governance and Democratic Services - 25 January 2023

For further information about the meeting, please contact Pam Pursley at ppursley@somerset.gov.uk or 01823 357628 or Stephanie Gold at stephanie.gold@somerset.gov.uk or 01823 357628

Guidance about procedures at the meeting follows the printed agenda and is available at (LINK)

This meeting will be open to the public and press, subject to the passing of any resolution under Regulation 4 of the Local Authorities (Executive Arrangements) (Meetings and Access to Information) (England) Regulations 2012.

This agenda and the attached reports and background papers are available on request prior to the meeting in large print, Braille, audio tape & disc and can be translated into different languages. They can also be accessed via the council's website on www.somerset.gov.uk/agendasandpapers

Are you considering how your conversation today and the actions you propose to take contribute towards making Somerset Carbon Neutral by 2030?

RNID typetalk

AGENDA

Item Audit Committee - 2.00 pm Thursday 2 February 2023

*** Public Guidance notes contained in agenda annexe ***

1 **Apologies for absence**

To receive members' apologies

2 **Declarations of Interest**

Details of all Members' interests in District, Town and Parish Councils can be viewed on the Council Website at
County Councillors membership of Town, City, Parish or District Councils and this will be displayed in the meeting room (Where relevant).

The Statutory Register of Member's Interests can be inspected via request to the Democratic Service Team.

3 **Minutes from the meeting held on 19th January 2023** (To Follow)

The Committee is asked to confirm the minutes are accurate**.**

4 **Public Question Time**

The Chair will allow members of the public to present a petition on any matter within the Committee's remit. Questions or statements about any matter on the agenda for this meeting will be taken at the time when each matter is considered.

5 **Somerset Council Audit committee terms of reference** (Pages 9 - 18)

The committee is asked to recommend to Somerset County Council that the Audit Committee Terms of Reference set out in Appendix A to this report are approved as the Audit Committee Terms of Reference to be included in the Constitution of Somerset Council from 1 April 2023.

The committee is asked to recommend that the Audit Committee of Somerset Council includes a review of the following matters in the light of the CIPFA Guidance in its 2023-24 workplan:

- The optimum size of the Audit Committee and the use of substitutes
- Its member training programme
- Independent members (appointment, training and remuneration)

6 **Treasury Management Strategy Statement 2023/2024** (Pages 19 - 110)

The Committee is asked to review the Treasury Management Strategy Statement 2023/2024, whether there are any suggestions or amendments that they would like to recommend to the Executive.

7 **Non Treasury Management Investment Strategy 2023/2024** (Pages 111 - 168)

The committee is asked to review the 2023/24 Non-Treasury Investment Strategy and to recommend its approval to the Executive and Full Council.

8 **Capital Strategy for 2023/24 to 2025/26** (Pages 169 - 186)

The Committee is asked to review the Capital Strategy for 2023/24 to 2025/26, whether there are any suggestions or amendments that they would like to recommend to the Executive.

9 **Flexible Capital Receipts Strategy 2022/23 and 2023/24** (Pages 187 - 192)

The Committee is asked to review the Flexible Capital Receipts Strategy for 2022/23 and 2023/24, whether there are any suggestions or amendments that they would like to recommend to the Executive.

10 **Minimum Revenue Provision Statement 2023/2024** (Pages 193 - 196)

The Committee is asked to review the Minimum Revenue Provision Statement 2023/24, whether there are any suggestions or amendments that they would like to recommend to the Executive.

11 **Audit committee work programme** (Pages 197 - 198)

The committee are asked to consider and comment on the Audit committee work programme.

12 **Any other urgent items of business**

The Chair may raise any items of urgent business.

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Guidance notes for the meeting

1. Inspection of Papers

Any person wishing to inspect Minutes, reports, or the background papers for any item on the Agenda should contact the Committee Administrator for the meeting via Telephone (01823) 359045 or 357628; or Email: democraticservices@somerset.gov.uk

They can also be found here: www.somerset.gov.uk/agendasandpapers

2. Members' Code of Conduct requirements

When considering the declaration of interests and their actions as a councillor, Members are reminded of the requirements of the Members' Code of Conduct and the underpinning Principles of Public Life: Honesty; Integrity; Selflessness; Objectivity; Accountability; Openness; Leadership. The Code of Conduct can be viewed at:

http://www.somerset.gov.uk/organisation/key-documents/the-councils-constitution/

3. Minutes of the Meeting

Details of the issues discussed and recommendations made at the meeting will be set out in the Minutes, which the Committee will be asked to approve as a correct record at its next meeting.

4. Public Question Time

If you wish to speak, please tell, the Committee's Administrator, by 5.00pm on the Friday before the meeting. This is the deadline to register to speak and requests to speak received after this time will be at the Chair of the Committee's discretion.

At the Chair of the Committee's invitation you may ask questions and/or make statements or comments about any matter on the Committee's agenda – providing you have given the required notice. You may also present a petition on any matter within the Committee's remit.

The length of public question time will be no more than 30 minutes in total.

A slot for Public Question Time is set aside near the beginning of the meeting, after the minutes of the previous meeting have been signed. However, questions or statements about any matter on the Agenda for this meeting may be taken at the time when each matter is considered.

You must direct your questions and comments through the Chair. You may not take direct part in the debate. The Chair will decide when public participation is to finish.

If there are many people present at the meeting for one item, the Chair may adjourn the meeting to allow views to be expressed more freely. If an item on the Agenda is contentious, with a large number of people attending the meeting, a representative should be nominated to present the views of a group.

An issue will not be deferred just because you cannot be present for the meeting. Remember that the amount of time you speak will be restricted, normally to two minutes only.

5. Exclusion of Press & Public

If when considering an item on the Agenda, the Committee may consider it appropriate to pass a resolution under Section 100A (4) Schedule 12A of the Local Government Act 1972 that the press and public be excluded from the meeting on the basis that if they were present during the business to be transacted there would be a likelihood of disclosure of exempt information, as defined under the terms of the Act.

6. Committee Rooms & Council Chamber and hearing aid users

To assist hearing aid users Committee meeting rooms have infra-red audio transmission systems. To use this facility, you we need a hearing aid set to the T position.

7. Recording of meetings

The Council supports the principles of openness and transparency. It allows filming, recording and taking photographs at its meetings that are open to the public - providing this is done in a non-disruptive manner. Members of the public may use Facebook and Twitter or other forms of social media to report on proceedings and a designated area will be provided for anyone wishing to film part or all of the proceedings.

No filming or recording may take place when the press and public are excluded for that part of the meeting. As a matter of courtesy to the public, anyone wishing to film or record proceedings is asked to provide reasonable notice to the Committee Administrator so that the relevant Chair can inform those present at the start of the meeting.

We would ask that, as far as possible, members of the public aren't filmed unless they are playing an active role such as speaking within a meeting and there may be occasions when speaking members of the public request not to be filmed.

The Council will be undertaking audio recording of some of its meetings in County Hall as part of its investigation into a business case for the recording and potential webcasting of meetings in the future.

A copy of the Council’s Recording of Meetings Protocol should be on display at the meeting for inspection, alternatively contact the Committee Administrator for the meeting in advance.

8. Operating Principles for Audit Committee

Reports

i. The reports should be clearly and concisely written. The report template available to officers on the intranet will be used.

ii. Reports should highlight issues for Member consideration, no matter how difficult or complex, for example:

- All reports should detail current performance levels.
- All reports should identify cost implications.

iii. No report should contain a recommendation "to note" the report.

iv. Any report, which outlines clear priorities for improvement, should contain recommendations and a detailed action plan with timescales and resources.

Members

i. Members should be clear about cost and resourcing issues highlighted in clearly and concisely written reports.

ii. Members should seek to understand the impact of reports on Council performance.

iii. Members can refer reports / issues back to the Cabinet where there are constructive concerns about services and/or performance.

9. The Role of the Audit Committee

(a) Approves (but not directs) internal audit's strategy, plan and performance;

(b) Reviews summary internal audit reports and the main issues arising, and seeks assurance that action has been taken where necessary;

(c) Considers the reports of external audit and inspection agencies;

(d) Ensures that the Council's assurance statements, including the Annual Governance Statement, properly reflect the risk environment and any actions required to improve it;

(e) Ensures that there are effective relationships between external and internal audit, inspection agencies and other relevant bodies, and that the value of the audit process and effective financial governance is actively promoted;

(f) Reviews the financial statements, external auditor’s opinion and reports to Members, and monitors management action in response to the issues raised by external audit;

(g) Approves the annual accounts of the Council and the Annual Governance Statement, together with considering the Matters Arising from the Accounts Audit.

Somerset County Council
Audit Committee - 2 February 2023

Somerset Council Audit Committee Terms of Reference

Lead Officer: Jason Vaughan
Author: Jill Byron, District Solicitor & Monitoring Officer South Somerset District Council
Contact Details: Jill.byron@somerset.gov.uk
Cabinet Member: Liz Leyshon
Division and Local Member:

1. Summary

1.1. Attached to this report are the suggested terms of reference for the Somerset Council Audit Committee. The terms of reference will form part of the post-vesting day Constitution, which will itself be adopted by this Council in the run-up to vesting day.

1.2. The terms of reference are based on those suggested by CIPFA for local authority audit committees. The report also recommends that the new Audit Committee considers other aspects of the CIPFA Guidance during the 2023-24 municipal year.

2. Recommendations

2.1. That the Audit Committee recommends to Somerset County Council that the Audit Committee Terms of Reference set out in Appendix A to this report are approved as the Audit Committee Terms of Reference to be included in the Constitution of Somerset Council from 1 April 2023.

2.2. That the Audit Committee of Somerset Council includes a review of the following matters in the light of the CIPFA Guidance in its 2023-24 workplan:

- The optimum size of the Audit Committee and the use of substitutes
- Its member training programme
- Independent members (appointment, training and remuneration)

3. Background

3.1. In preparation for the vesting of Somerset Council on 1 April 2023, a new Constitution is being drafted for adoption prior to vesting day. The Audit Committee Terms of Reference form part of the Constitution.

3.2. In 2022, CIPFA issued a Position Statement on Audit Committees in Local Authorities and associated Guidance which has been endorsed by the Department for Levelling Up, Housing and Communities and the Home Office (see Background Papers). The items set out at paragraph 5.1 of Appendix A are the CIPFA recommended terms of reference.

3.3. The items set out at paragraphs 5.2 and 5.3 of Appendix A are optional additional terms of reference recommended for adoption and, apart from the Annual Approvals, have been taken from the CIPFA Guidance.

3.4. The CIPFA Guidance suggests that audit committees should actively consider their size and the appointment of independent members, and also review the attributes and training of all their members. CIPFA suggest that when selecting elected representatives or co-opting independent members, aptitude should be considered alongside relevant knowledge, skills and experience and that members are

- trained to fulfil their role in a way that ensures they are objective, have an inquiring and independent approach, and are knowledgeable; and.

- enabled to promote good governance principles, identifying ways that better governance arrangement can help achieve the organisation's objectives.

- prepared to operate in an apolitical manner, treating auditors, the executive and management fairly, but able to challenge the executive and senior managers when required.

The Guidance notes that while expertise in the areas within the remit of the committee is very helpful, the attitude of committee members and willingness to have appropriate training is of equal importance.

3.5. The revised Guidance from CIPFA is relatively new and it is recommended that the Audit Committee's work plan for 2023-24 includes a review of these areas and the CIPFA Guidance generally.

4. Consultations undertaken

4.1. The terms of reference have been considered by the members of both the LGR Programme's Governance Workstream and Finance Workstream and their comments have been taken into account.

5. Background papers

5.1. The following CIPFA Publications:
CIPFA's Position Statement: Audit Committees in Local Authorities and Police 2022

Audit Committees: practical guidance for local authorities and police (2022 edition) - The audit committee member in a local authority

Audit Committees: practical guidance for local authorities and police (2022 edition) - Guiding the audit committee: Supplement to the audit committee member guidance

Note For sight of individual background papers please contact the report author

Part D – AUDIT COMMITTEE TERMS OF REFERENCE

1. General

1.1 The Audit Committee is a key component of the Council's governance framework. Its purpose is to provide an independent and high-level focus on the adequacy of governance, risk and control arrangements. The Committee's role in ensuring that there is sufficient assurance over governance risk and control gives greater confidence to all those charged with governance that those arrangements are effective. The Audit Committee has oversight of both internal and external audit together with the financial and governance reports, helping to ensure that there are adequate arrangements in place for both internal challenge and public accountability.

1.2 The Audit Committee is directly accountable to Full Council. It is independent of both the executive and the scrutiny functions and is a key advisory committee providing independent oversight, recommendations, opinions and influence on the matters for which it is responsible. To assist the Audit Committee in fulfilling its role, it has a right of access to and is expected to engage constructively with other committees and functions, for example scrutiny and service committees, corporate risk management boards and other strategic groups. The Audit Committee also has the right to request reports and seek assurances from relevant officers.

1.3 The terms of reference will be formally approved by the Council.

1.4 These terms of reference shall be reviewed by the Council on the advice of the Committee and on a regular basis to ensure that they remain fit for purpose and in accordance with any relevant regulations and guidance. Any revisions will be agreed by the Council and by the Committee.

2. Membership, Chairmanship and Quorum

Number of Members	15 (includes up to 2 Independent members)
Substitute Members Permitted	Yes, provided they have met the training requirement set out in paragraph 7
Political Balance Rules apply	Yes
Appointments/Removals from Office	By resolution of full Council
Restrictions on Membership	Executive members and their deputies may not be a member of this Committee
Restrictions on Chairmanship/Vice-Chairmanship	None

Quorum	One quarter of the number of voting members rounded up (to include either the Chair or Vice-Chair)
Number of ordinary meetings per Council Year	At least 4 per year

3. Responsibilities of the Chair

3.1 The Chair is responsible for:

(a) ensuring the Committee delivers its purpose as set out in the Committee's terms of reference;
(b) the arrangements for meetings of the Committee;
(c) ensuring that Committee meetings are productive and effective and that opportunity is provided for the views of all Committee members to be expressed and considered; and
(d) seeking to achieve the consensus of all Committee members on the business presented to the Committee and ensure that decisions are properly put to a vote when that cannot be reached.

4. Definitions

AGS means the Council's Annual Governance Statement
CIPFA Guidance means the following documents as amended or updated from time to time:

- CIPFA's Position Statement: Audit Committees in Local Authorities and Police 2022
- Audit Committees: practical guidance for local authorities and police (2022 edition – CIPFA) - The audit committee member in a local authority
- Audit Committees: practical guidance for local authorities and police (2022 edition – CIPFA) - Guiding the audit committee: Supplement to the audit committee member guidance

LGAN means the Local Government Application Note supporting the **PSIAS**
PSAA means Public Sector Audit Appointments Ltd
PSIAS means the Public Sector Internal Audit Standards
QAIP means the Internal Audit Quality Assurance and Improvement Programme

5. Terms of Reference

5.1 As set out in the CIPFA Guidance, the Audit Committee's principal duties are:

Governance, risk and control

- To review the council's corporate governance arrangements against the good governance framework, including the ethical framework, and consider the local code of governance.
- To monitor the effective development and operation of risk management in the council.
- To monitor progress in addressing risk-related issues reported to the committee.
- To consider reports on the effectiveness of internal controls and monitor the implementation of agreed actions.
- To consider reports on the effectiveness of financial management arrangements, including compliance with CIPFA's **Financial Management Code**.
- To consider the council's arrangements to secure value for money and review assurances and assessments on the effectiveness of these arrangements.
- To review the assessment of fraud risks and potential harm to the council from fraud and corruption.
- To monitor the counter fraud strategy, actions and resources.
- To review the governance and assurance arrangements for significant partnerships or collaborations.

Financial and governance reporting

Governance reporting

- To review the **AGS** prior to approval and consider whether it properly reflects the risk environment and supporting assurances, including the head of internal audit's annual opinion.
- To consider whether the annual evaluation for the **AGS** fairly concludes that governance arrangements are fit for purpose, supporting the achievement of the authority's objectives.

Financial reporting

- To monitor the arrangements and preparations for financial reporting to ensure that statutory requirements and professional standards can be met.
- To review the annual statement of accounts. Specifically, to consider whether appropriate accounting policies have been followed and whether there are concerns arising from the financial statements or from the audit that need to be brought to the attention of the council.
- To consider the external auditor's report to those charged with governance on issues arising from the audit of the accounts.

Arrangements for audit and assurance

To consider the council's framework of assurance and ensure that it adequately addresses the risks and priorities of the council.

External audit

- To support the independence of external audit through consideration of the external auditor's annual assessment of its independence and review of any issues raised by **PSAA** or the authority's auditor panel as appropriate.
- To consider the external auditor's annual letter, relevant reports and the report to those charged with governance.
- To consider specific reports as agreed with the external auditor.
- To comment on the scope and depth of external audit work and to ensure it gives value for money.
- To consider additional commissions of work from external audit.
- To advise and recommend on the effectiveness of relationships between external and internal audit and other inspection agencies or relevant bodies.
- To provide free and unfettered access to the audit committee chair for the auditors, including the opportunity for a private meeting with the committee.

Internal audit

- To approve the internal audit charter.
- To review proposals made in relation to the appointment of external providers of internal audit services and to make recommendations.
- To approve the risk-based internal audit plan, including internal audit's resource requirements, the approach to using other sources of assurance and any work required to place reliance upon those other sources.
- To approve significant interim changes to the risk-based internal audit plan and resource requirements.
- To make appropriate enquiries of both management and the head of internal audit to determine if there are any inappropriate scope or resource limitations.
- To consider any impairments to the independence or objectivity of the head of internal audit arising from additional roles or responsibilities outside of internal auditing and to approve and periodically review safeguards to limit such impairments.
- To consider reports from the head of internal audit on internal audit's performance during the year, including the performance of external providers of internal audit services. These will include:
  - updates on the work of internal audit, including key findings, issues of concern and action in hand as a result of internal audit work

  - regular reports on the results of the **QAIP**
  - reports on instances where the internal audit function does not conform to **PSIAS** and **LGAN**, considering whether the non-conformance is significant enough that it must be included in the **AGS**.
- To consider the head of internal audit's annual report, including:
  - the statement of the level of conformance with **PSIAS** and **LGAN** and the results of the **QAIP** that support the statement (these will indicate the reliability of the conclusions of internal audit)
  - the opinion on the overall adequacy and effectiveness of the council's framework of governance, risk management and control, together with the summary of the work supporting the opinion (these will assist the committee in reviewing the **AGS**).
- To consider summaries of specific internal audit reports as requested.
- To receive reports outlining the action taken where the head of internal audit has concluded that management has accepted a level of risk that may be unacceptable to the authority or there are concerns about progress with the implementation of agreed actions.
- To contribute to the **QAIP** and in particular to the external quality assessment of internal audit that takes place at least once every five years.
- To consider a report on the effectiveness of internal audit to support the **AGS** where required to do so by the accounts and audit regulations.
- To provide free and unfettered access to the audit committee chair for the head of internal audit, including the opportunity for a private meeting with the committee.

Accountability arrangements

- To report to those charged with governance on the committee's findings, conclusions and recommendations concerning the adequacy and effectiveness of their governance, risk management and internal control frameworks, financial reporting arrangements and internal and external audit functions.
- To report to full council on a regular basis on the committee's performance in relation to the terms of reference and the effectiveness of the committee in meeting its purpose.
- To publish an annual report on the work of the committee, including a conclusion on the compliance with the **CIPFA Position Statement**.

5.2 In addition to the principal duties set out in 5.1 above, the Audit Committee will:

Annual Approvals

- approve the annual accounts of the Council and the Annual Governance Statement.

Treasury Management

- provide an overview role in Treasury Management matters including regular monitoring of treasury activity and practices.
- review and recommend the Non-Treasury Management Investment Strategy, the Capital Strategy, the Flexible Capital Receipts Strategy, the MRP Strategy, and any appropriate Prudential Indicators to Council.

5.3 In addition to the principal duties set out in 5.1 and 5.2 above, the Audit Committee may be requested to consider a review of a service, a proposed policy or other similar matters by another committee in the organisation or by one of the statutory officers, provided the matter relates to governance, risk or control and the committee does not take on a scrutiny or policy role. Examples of where it may be helpful for the audit committee to assist include:

- reviewing whether adequate governance, risk management or audit processes are in place in relation to a specific service or new policy area
- providing advice to the executive on possible risks or implications for good governance arising from a proposed course of action or decision.

In each case, the aim of the committee should be to make recommendations in line with its role as set out in paragraph 1 above to help ensure that there are appropriate governance, risk, control and assurance arrangements in place. Audit committee recommendations under this paragraph may support the advice or recommendations of the statutory officers but cannot override that advice.

6. Conflicts of interest

6.1 All members of the Committee must declare on appointment and at any such time as their circumstances change any potential conflict of interest arising as a result of their position on the Committee.

6.2 The Council's Monitoring Officer shall include interests registered by all members of the Committee in the published Members' and Co-opted Members' Register of Interests. All such interests are to be registered with the Monitoring Officer within 28 days of appointment to the Committee.

7. Knowledge and understanding including training

7.1 All new members must follow an induction training plan and all members of the Committee will be expected to attend the training provided to ensure that they have the requisite knowledge and understanding to fulfil their role.

7.2 The Committee has adopted a training policy and all members of the Committee are expected to meet the requirements of that policy.

7.3 Failure to attend training may lead to removal from the Committee.

8. Independent Members

8.1 Up to two Independent members may be appointed by Somerset Council as non-voting members of the Committee.

8.2 Independent members of the Committee shall be appointed and co-opted for a three year term by the Somerset Council following an open and transparent appointments process which considers aptitude, relevant knowledge, skills and experience.

8.3 Independent members of the Committee may only be removed during their term of office for good cause by the Somerset Council at a Full Council meeting. It is for the Council, acting reasonably, to determine whether or not it has good cause to terminate before the normal expiry of the term of the Independent Member.

9. Meetings

9.1 The frequency of meetings is to be determined by the Committee once it has agreed a workplan, with a minimum of four meetings annually. In addition to this, training sessions will be held as necessary to ensure that Committee members have sufficient knowledge and skills to undertake the role.

9.2 The Committee will meet at the Council's main offices, or another location to be agreed by the Chair. Meetings will normally be held during normal working hours at times to be agreed by the Chair.

9.3 As a committee of the Council, the **Committee Structure and Procedure Rules** set out in Part D of the Council's Constitution apply to meetings of the Committee. Committee meetings will be held in open session with closed sessions where appropriate. The agenda papers will be circulated to members of the Committee and published in advance of meeting in line with Council policy. The minutes of meetings will be recorded and published in line with Council policy.

9.4 The following individuals may put items on the Committee's agenda:

- the Chair of the Committee
- any member of the Committee, including co-opted members
- the Chair of Council or any other Committee
- any statutory officer or their deputy
- the Council's external auditor
- the Council's internal auditor

10. Code of Conduct

10.1 All members of the Committee will be required to formally sign up to comply with the Somerset Council Code of Conduct

Treasury Management Strategy Statement 2023-24

Executive Member(s): Cllr Liz Leyshon – Executive Member for Resources
Local Member(s) and Division: All
Lead Officer: Jason Vaughan – Director of Finance & Governance (Section 151 Officer)
Author: Alan Sanford – Principal Investment Officer
Contact Details: alan.sanford@somerset.gov.uk or (01823) 359585

1. Summary / Background

1.1. This document sets out proposed Treasury Management strategy for the new Somerset Council (SC) for 2023-24. It brings together the legacy investment and debt portfolios of the 5 councils (as they are known at present) and puts forward proposals for how best to use and adapt current portfolios, to achieve the capital and revenue needs of the new Council going forward. Only Treasury Management investments are dealt with in this strategy. Investments held for service purposes or for commercial activity primarily for yield, collectively referred to as non-treasury investments, are considered in a separate report, the Investment Strategy.

The Council recognises that effective treasury management underpins the achievement of its business and service objectives and is essential for maintaining a sound financial reputation. It is therefore committed to driving value from all of its treasury management activities and to employing suitable performance measurement techniques, within the context of effective risk management.

This report brings together the requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services Code of Practice Revised 2021 Edition (CIPFA TM Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities: Revised 2021 Edition (CIPFA Prudential Code).

The revised CIPFA Prudential Code, does not require that existing commercial investments, including property, be sold, but authorities that have an expected need to borrow should review options for exiting their financial investments for commercial purposes and summarise the review in their annual Treasury Management or Investment Strategies. For obvious reasons a full review of the amalgamated commercial investment portfolio has yet to take place. This has a knock-on effect to Treasury borrowing decisions for 2023-24.

Whilst most of the requirements of the 2018 Department of Levelling Up, Housing, and Communities (DLUHC) Investment Guidance are no longer relevant to Treasury Management Investments (it now overwhelmingly refers to non-treasury investments), it does adhere to DLUHC guidance to prioritise Security, Liquidity and Yield, in that order.

As at 30th September 2022, the 5 Councils combined held nearly £776m of debt as part of their strategy for funding previous years' capital programmes. Of this, ££207m is short-term borrowing, mostly due to mature within one year, and primarily borrowed from other Local Authorities. £375.4m is Public Works Loan Board (PWLB) debt, £108m is Lender Option Borrower Option (LOBO) debt, and a further £57.5m of fixed rate bank loans.

The 5 Councils' joint investment balances as at 30th September 2022 stood at just over £454m. This includes approximately £130m of cash held for either external bodies, or entities where the Council is the accountable/administering body. Within this figure £144.3m is invested in Strategic Funds. The largest holding within this figure is a £31m holding in the Churches, Charities, Local Authorities (CCLA) Property Fund.

2. Recommendations

2.1. The Executive is asked to endorse the following and recommend approval by Full Council on 1st March 2023:

1. To adopt the Treasury Borrowing Strategy (as shown in Section 12 of the report).
2. To approve the Treasury Investment Strategy (as shown in Section 13 of the report) and proposed Lending Counterparty Criteria (attached at **Appendix B** to the report).
3. To adopt the Prudential Treasury Indicators in section 14.
4. To note **Appendix A**, that is adopted as part of the Councils Financial regulations.
5. To note the current Treasury Management Practices (TMPs) attached at **Appendix D** to the report.

3. Reasons for recommendations

3.1 Under new CIPFA guidance the Treasury Management Strategy (TMS) can be delegated to a committee of the Council under certain conditions. However, it is seen as a key element of the overall Capital Strategy and as that must be presented to the Full Council, it is regarded as appropriate that the TMS should be part of that process.

4. Other options considered

4.1. None. The adoption of the TMS is a regulatory requirement.

5. Links to County Vision, Business Plan and Medium-Term Financial Strategy

5.1. Effective Treasury Management provides support to the range of business and service level objectives that together help to deliver the Somerset County Plan.

6. Consultations and co-production

6.1. None. The adoption of the TMS is a regulatory requirement.

7. Financial and Risk Implications

7.1. The budget for investment income in 2023-24 is £13.0m, based on an average investment portfolio of £350m at an average return of 3.75% (these figures are net of balances held on behalf of external investors i.e. the Local Enterprise Partnership). The budget for debt interest paid in 2023-24 is £32.2m, based on an average debt portfolio of £835m at an average interest rate of 3.84% (note 4.7% for new debt). If actual levels of investments or borrowing, or actual interest rates, differ from the forecast, performance against budget will be correspondingly different.

7.2. The TMS is the Council's document that sets out strategy and proposed activities to conduct Treasury Management activity while mitigating risks. **Appendix D**, the Treasury Management Practices document gives detailed explanation of the policies and procedures specifically used in treasury risk management.

8. Legal and HR Implications

8.1. Treasury Management must operate within specified legal and regulatory parameters as set out in the summary, and in more detail in the TMPs.

8.2. There are no HR implications.

9. Other Implications

9.1. Equalities Implications

There are no equalities implications.

9.2. Community Safety Implications

There are no community safety implications.

9.3. Sustainability Implications

There are no sustainability implications.

9.4. Health and Safety Implications

There are no health and safety implications.

9.5. Health and Wellbeing Implications

There are no health and wellbeing implications.

9.6. Social Value

Not applicable

10. Scrutiny comments / recommendations:

10.1. The Audit Committee is the body responsible for ensuring effective scrutiny of the treasury management strategy and policies.

11 Introduction and Background

Treasury management is the management of the Council's cash flows, borrowing and treasury investments, and the associated risks. The Council has significant debt and treasury investment portfolios 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.

Investments held for service purposes or for commercial profit, collectively referred to as non-treasury investments, are considered in a separate report, the Investment Strategy.

Treasury risk management at the Council is conducted within the framework of the CIPFA Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA TM Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA TM Code.

Within the new code, the new section, 'Prudence in borrowing and investment' is the key change in the code. It states "legitimate examples of prudent borrowing" as:

- Financing capital expenditure primarily related to the delivery of a local authority's functions.
- Temporary management of cash flow within the context of a balanced budget.
- Securing affordability by removing exposure to future interest rate rises.
- Refinancing current borrowing, including adjusting levels of internal borrowing, to manage risk, reduce costs or reflect changing cash flow circumstances.
- Other treasury management activity that seeks to prudently manage treasury risks without borrowing primarily to invest for financial return.

The CIPA 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; therefore, in order to comply with the CIPFA Prudential Code:

- An authority must not borrow to invest primarily for financial return.
- It is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, 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.

Under Section 3 of the Local Government Act 2003 (duty to determine affordable borrowing limit), a Local Council must have regard to the CIPFA Prudential Code. This code requires the setting of a number of Prudential Indicators, benchmarks within which Treasury and Investment Management, and Capital Financing are managed. The setting of Prudential Indicators for Treasury Management requires Authorities to recognise key implications of their borrowing and investment strategies. These relate to the affordability of overall borrowing limits, the maturity structure of borrowing, and longer-term investments.

In formulating the Treasury Management Strategy, and the setting of Prudential Indicators, Somerset Council (SC) adopts the Treasury Management Framework and Policy recommended by CIPFA. These can be found in **Appendix A**.

The current TMPs are attached for information as **Appendix D** to this report and set out the main categories of risk that may impact on the achievement of Treasury Management objectives. No treasury management activity is without risk. The successful identification, monitoring and control of risks are the prime criteria by which the effectiveness of its treasury management activities will be measured. The main risks to the Council's treasury activities are:

- Credit and Counterparty Risk (security of investments)
- Liquidity Risk (inadequate cash resources)
- Market or Interest Rate Risk (fluctuations in price / interest rate levels)
- Refinancing Risk (impact of debt maturing in future years)
- Legal & Regulatory Risk.

The schedules to the TMPs provide details of how these risks are actively managed. This is a living document and will be updated to reflect any new policies and structures as a result of the ongoing creation of the new Somerset Council.

External Context

Economic background: The ongoing impact on the UK from the war in Ukraine, together with higher inflation, higher interest rates, uncertain government policy, and a deteriorating economic outlook, will be major influences on the Authority's treasury management strategy for 2023-24.

The Bank of England (BoE) increased Bank Rate by 0.5% to 3.5% in December 2022. This followed a 0.75% rise in November which was the largest single rate hike since 1989 and the ninth successive rise since December 2021. The December decision was voted for by a 6-3 majority of the Monetary Policy Committee (MPC), with two dissenters voting for a no-change at 3% and one for a larger rise of 0.75%.

The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

The UK economy contracted by 0.3% between July and September 2022 according to the Office for National Statistics, and the BoE forecasts Gross Domestic Product (GDP) will decline 0.75% in the second half of the calendar year due to the squeeze on household income from higher energy costs and goods prices. Growth is then expected to continue to fall throughout 2023 and the first half of 2024.

CPI inflation is expected to have peaked at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets at the time of the November MPR (a peak of 5.25%). However, the BoE stated it considered this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target. Market rates have fallen since the time of the November MPR.

The labour market remains tight for now, with the most recent statistics showing the unemployment rate was 3.7%. Earnings were up strongly in nominal terms by 6.1% for both total pay and for regular pay but factoring in inflation means real pay for both measures was -2.7%. Looking forward, the November MPR shows the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.5% in December 2022 to 4.25%-4.5%. This rise follows four successive 0.75% rises in a pace of tightening that has seen rates increase from 0.25%-0.50% in March 2022. Annual inflation has been slowing in the US but remains above 7%. GDP grew at an annualised rate of 3.2% (revised up from 2.9%) between July and September 2022, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

Inflation rose consistently in the Euro Zone since the start of the year, hitting a peak annual rate of 10.6% in October 2022, before declining to 10.1% in November. Economic growth has been weakening with an upwardly revised expansion of 0.3% (from 0.2%) in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.50% in December, following two consecutive 0.75% rises, taking its main refinancing rate to 2.5% and deposit facility rate to 2.0%.

An economic and interest rate forecast provided by Arlingclose is attached at **Appendix C.**

Internal Context
As at 30th September 2022 the external long-term debt portfolio of SC stood at just under £776m as in **table 1** below.

Table 1 – Debt Portfolio

	Mendip £m	Sedgemoor £m	SCC £m	SSDC £m	SWT £m	Total £m
Short Term Borrowing	0.00	15.00	0.00	114.00	73.00	202.00
Intra-Authority	0.00	25.00	0.00	0.00	0.00	25.00
PWLB	62.79	66.06	159.05	0.00	92.50	380.40
LOBOs	0.00	0.00	108.00	0.00	0.00	108.00
Fixed Rate Loans	0.00	0.00	57.50	0.00	3.00	60.50
Total Borrowing	**62.79**	**106.06**	**324.55**	**114.00**	**168.50**	**775.90**

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while useable reserves and working capital are the underlying resources available for investment.

Statutory guidance is that debt should remain below the CFR, except in the short-term. The Council expects to comply with this in the medium term.

The investment portfolio set out in **Table 2** below, at the same time stood at just over £454m, although as at 30th September 2022 just over £130m was cash held on behalf of other entities, primarily where Somerset County Council is the accountable / administering body.

Table 2 – Investments as at 30th September 2022

	Mendip £m	**Sedgemoor £m**	**SCC £m**	**SWT £m**	**SSDC £m**	**Total £m**
Call / Notice A/cs	1.02	5.00	20.00	0.00	0.00	26.02
Money Market Funds	12.20	6.20	10.30	6.40	0.70	35.80
Time Deposits / CDs - Banks	0.00	0.00	155.00	0.00	0.00	155.00
Time Deposits - LAs	0.00	0.00	60.00	0.00	0.00	60.00
DMO	0.00	0.00	0.00	9.90	3.00	12.90
Intra-Authority Loans	0.00	0.00	20.00	0.00	0.00	20.00
Strategic Funds	28.00	31.00	45.00	16.80	23.50	144.30
Total Investments	**41.22**	**42.20**	**310.30**	**33.10**	**27.20**	**454.02**

In **table 3** below, as shown in the Capital Strategy, the 'Assumed debt not yet taken' row indicates a requirement to borrow to finance the capital programme We are currently in discussion with District colleagues regarding borrowing requirements up to vesting day. Timings of actual capital expenditure linked to the capital plan are not totally predictable.

Table 3 - External Debt and the Capital Financing Requirement

	31.3.2023 forecast £m	**31.3.2024 budget £m**	**31.3.2025 budget £m**	**31.3.2026 budget £m**
Short term debt	N/A	210.0	210.0	210.0
Long term debt *	N/A	522.8	511.5	499.6
Assumed debt not yet taken	N/A	261.0	260.0	274.5
PFI & leases	N/A	77.3	76.0	74.7
Total external borrowing	**N/A**	**1,071.1**	**1,057.5**	**1,058.8**
Housing Revenue Account	189.3	210.3	210.3	214.8
General Fund	945.2	1,022.1	1,031.0	1,015.7
Total CFR	**1,134.5**	**1,232.4**	**1,241.3**	**1,230.5**

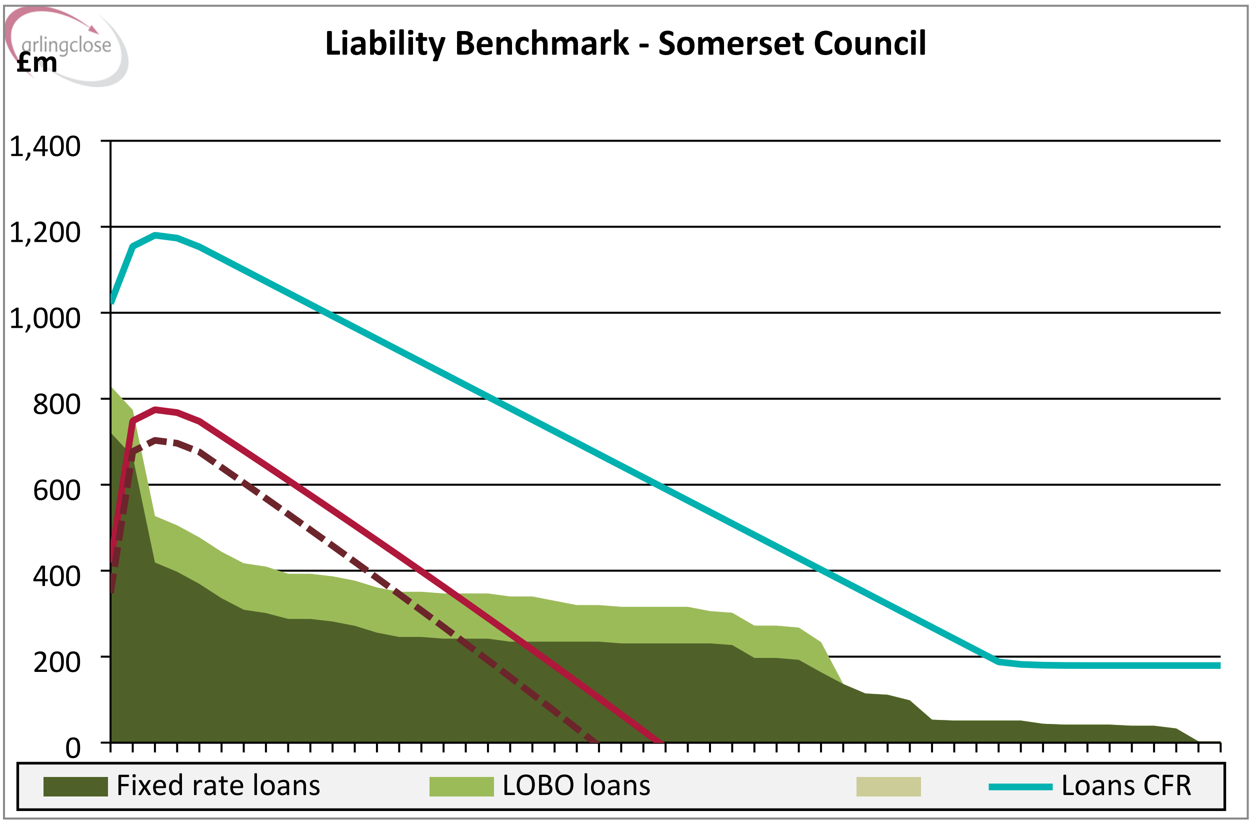
*Reduces for Minimum Revenue Provision (MRP) & debt repayment

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 3 shows that the Authority expects to comply with this recommendation during 2023-24.

Liability Benchmark: To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 3 above, but that cash and investment balances are kept to a minimum level of £75m at each year-end to maintain sufficient liquidity but minimise credit risk.

The liability benchmark is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

Following on from the medium-term forecasts in table 3 above, the long-term liability benchmark assumes capital expenditure funded by borrowing of £260m next year, minimum revenue provision on new capital expenditure based on a blend of previous District and County approaches and income, expenditure and reserves all increasing by inflation. This is shown in the chart below together with the maturity profile of the Authority's existing borrowing:



The concept is that the chart allows a comparison of current borrowing against the need to borrow, looking at both the amount (on the y axis) and the term (on the x axis). Where actual loans exceed the Liability Benchmark, the authority can make long-term investments for cash flow management or repay loans early; where the Liability Benchmark exceeds loans, the authority can take long-term borrowing or sell investments.

There is no requirement to borrow exactly to the Liability Benchmark, but a decision to borrow more or less, or longer or shorter, than the Liability Benchmark implies a deliberate decision to accept additional risk. This may be entirely appropriate if it is accompanied by a reduction in cost, for example through short-term borrowing at lower margins. The Liability Benchmark provides the tool for local authorities to measure this risk and make such risk/reward decisions openly and explicitly.

These factors represent significant cash flow, and debt and investment portfolio management for the Council's Officers. In the current financial and economic environment and taking into account potential influencing factors, it is imperative that the Council has strategies and policies in place to manage flows and balances effectively. The strategies and policies herein state the objectives of Treasury Management for the year and set out the framework to mitigate the risks to successfully achieve those objectives.

12 <u>Borrowing Strategy</u>

The Council's need to borrow for capital purposes is determined by the capital programme. Council Members are aware of the major projects identified by the 4-year capital medium-term financial plan (MTFP). The Council currently holds £775.95m of loans, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in the table above shows that the Council will have a need to borrow in future years.

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

Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio.

A key determinant of borrowing strategy will be the full review of the amalgamated non-treasury investment portfolio. The revised CIPFA Prudential Code, whilst not requiring that existing commercial investments, including property, be sold, does state that authorities that have an expected need to borrow should review options for exiting their financial investments for commercial purposes as part of the borrowing decision-making process. Whilst the review of non-treasury investments is taking place during 2023-24 it may be necessary to borrow before the full position is analysed and understood.

There is a sizeable proportion of the current debt portfolio that is short-term and will need to be refinanced during 2023-24. The strategy would therefore be to refinance or take any required new debt whilst balancing the needs of budgets and introducing the least possible risk into the long-term debt portfolio as the fully amalgamated picture emerges.

With borrowing rates expected to rise and then plateau in the coming months, before reducing from late 2024 (see forecasts in appendix C) it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short (1-3 years) via the local authority market. As medium-term PWLB loans (10-20 years) are currently lower than short and long-term rates, a proportion of loans from the PWLB in this period would provide a suitable balance to the risk of holding too much short-term borrowing. This would be in line with the debt profile indicated by the liability benchmark and would dovetail with existing portfolios.

The Council has previously raised most of its long-term borrowing from the PWLB or via LOBOs with banks. Current policy is not to take further LOBO loans. The Council will continue to assess alternatives to borrowing long-term loans from other sources including banks, pension funds and local authorities, and may wish to investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA TM Code.

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

The use of Call Accounts and Money Market Funds (MMFs) will continue for short-term liquidity; however, it may be appropriate and/or necessary to borrow short-term (1 week to 3 months) to cover cash flow fluctuations. Where this is deemed advantageous, short-term funds will be obtained from the money market using the services of a panel of money market brokers.

Sources of borrowing: Approved sources of borrowing are cited in the TMPs. Since PWLB rates were reduced in December 2020, commercial lenders' offerings are less attractive than previously, but this option will still be sought and considered. It is envisaged that any new borrowing will be in the short to medium-term periods (up to 20 years), as this is most compatible with the liability benchmark and current maturity profile. A smaller amount of longer-dated borrowing may also be deemed appropriate when considering the overall portfolio.

Variable rate loans currently mitigate the cost of carry. Shorter-dated Equal Instalment of Principal (EIP) loans are cheaper than loans paid on maturity and are repaid systematically in equal instalments over their life. Both will be actively considered, as will shorter dated loans (1-3 years) from other Local Authorities.

No new borrowing will be in the form of LOBOs. Interest rates having risen recently and there is now a reasonable chance that lenders will exercise their options. SC will continue with the current policy not to accept any option to pay a higher rate of interest on its' LOBO loans and will exercise its own option to repay the loan should a lender exercise an option. This would reduce refinancing risk in later years. SC will also investigate opportunities to repay where a lender is looking to exit the LOBO by selling the loan. This would be undertaken in conjunction with our treasury advisors. SC may utilise cash resources for repayment or may consider replacing any loan(s) by borrowing from other sources. Depending on prevailing rates and the amount to be repaid, new loans might be taken over a number of maturities. The 'Maturity Structure of Borrowing' indicators have been set to allow for this contingency strategy.

Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates relative to the rate of the loan. 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 saving or a reduction in risk. The recent rise in interest rates means that more favourable debt rescheduling opportunities should arise than in previous years.

13 Treasury Investment Strategy

The revised CIPFA codes were designed to deal with investments specifically held primarily for yield (non-Treasury investments). Previously this did not include the use of Pooled Funds, but it now seems as if they may fall somewhere between the treasury and non-Treasury investment categories. SC and our advisors Arlingclose would argue that they are very much used as a Treasury investment by SC, matching the reserve requirements and debt liabilities.

There will be a review of all Pooled Funds, to ascertain whether the amalgamated portfolio remains appropriate in substance, size, and diversification.

The Council's treasury investments can be divided into two areas. Money that is invested to help smooth anticipated monthly cash flow movements, and funds which have been identified as not being immediately required (core balances), which can be invested over a longer timeframe. Total investment balances as at September 2022 were £454.02m. These balances include just over £130m of cash held on behalf of other entities by Somerset County Council.

As is likely, that a passive borrowing strategy is adopted, i.e. internal borrowing to fund capital expenditure, investment levels will likely decrease. If non-treasury or pooled fund positions are exited, investment balances could possibly be higher.

Objectives: The CIPFA TM Code requires the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The 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 Council aims to be a responsible investor and will consider environmental, social, and governance (ESG) issues when investing.

Strategy: As demonstrated by the liability benchmark above, the Council expects to be a long-term borrower and new treasury investments will therefore be made primarily to manage day-to-day cash flows using short-term low risk instruments. Subject to review, the existing portfolio of strategic pooled funds will be maintained to diversify risk into different sectors and to boost investment income.

ESG policy: ESG (Environmental, Social, and Governance) considerations are increasingly a factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the Council's ESG policy does not currently include ESG scoring or other real-time ESG criteria at an individual investment level. The Council will look to develop a more effective ESG policy as this area develops.

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

Implementation: The Section 151 Officer (Director of Finance & Governance) under delegated powers will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. The Director of Finance & Governance in turn delegates responsibility for implementing policy to Treasury Management Officers. This is done by using only the agreed investment instruments, and credit criteria below and in **appendix B.** As is current procedure, the use of a new instrument or counterparty would be proposed in conjunction with the Council's Treasury Advisors, Arlingclose and specifically authorised by the Section 151 Officer (Director of Finance & Governance).

Approved Investments: The list below shows currently approved instruments, with a brief description of current and potential investment instrument characteristics underneath.

- Business Reserve Accounts and term deposits.
- Deposits with other Local Authorities.
- Low Volatility Net Asset Value (LVNAV) Money Market Funds
- The Debt Management Office (DMO)
- Variable Net Asset Value (VNAV) Money Market Funds.
- Gilts and Treasury Bills.
- Certificates of Deposit with Banks and Building Societies
- Commercial Paper
- Use of any public or private sector organisation that meets the creditworthiness criteria rather than just banks and building societies.
- Building Societies – Including unrated Societies with better creditworthiness than their credit rated peers.
- Corporate Bonds – Can offer access to high credit rated counterparties, such as utility, supermarket, and infrastructure companies.
- Covered Bonds and Reverse Repurchase Agreements (Repos) present an opportunity to invest short-term with banks on a secured basis and hence be exempt from bail-in
- Pooled Funds. These funds allow the Council to diversify into asset classes other than those above, without the need to own and manage the underlying investments. Bond, equity and property funds offer enhanced returns over the longer term but are more volatile in the short term. Their values change with market prices, so will be considered for longer investment periods. It would be the Council's intention to be invested in longer-dated Bond Funds, Equity Funds, or Property Funds for at least 3-5 years.

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.

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.

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.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in but are exposed to the risk of the company going insolvent.

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

Pooled Funds: Shares or units in diversified investment vehicles. 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 liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

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 other asset classes without the need to own and manage the underlying investments.

Pooled funds would be the likely vehicles to diversify into more longer-term strategic investments but pose risks to both Security (of market value of investment), and to Liquidity of SC investments.   Because the value of pooled fund investments is subject to market fluctuations, there is a possibility that at any given time, the value of the Council's investment could be less than the original sum. However, there would be no realised loss until such time as the investment was sold. Currently there is a statutory override on accounting treatment that means nominal market losses at year-end do not need to be taken through the Income and Expenditure account if certain criteria are met. This might not always be the case in the future.

This risk is mitigated by taking a longer-term view of any investment, initially at least for 3 to 5-years. This would help to smooth any volatility in market values. Current accounting treatment (runs until 31st March 2023) may mitigate the reputational risk of reporting a loss in the I & E, as a 'Pooled Funds Adjustment Account' reserve will hold any unrealised losses (or gains) in capital value.

As Pooled Funds become a greater part of the overall portfolio, investments would be diversified among asset classes so that risks to any specific asset class would be limited.

Liquidity risk–Typically, Pooled Funds are extremely liquid, but by mitigating the risk of capital loss (by having to sell at a price lower than the initial sum invested), Investment would potentially lock away capital for 3 to 5-years plus. The Section 151 Officer will mitigate liquidity risk by determining the level of prudent investment, with reference to the level of core balances and reserves, commensurate with that timeframe.

Upside risk is that income returns are positive and remain above today's cash investment rates. There may also be potential for capital growth.

Real estate investment trusts: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

Credit outlook:
Credit default swap (CDS) prices have followed an upward trend throughout the year, indicating higher credit risk. They have been boosted by the war in Ukraine, increasing economic and political uncertainty and a weaker global and UK outlook, but remain well below the levels seen at the beginning of the Covid-19 pandemic. CDS price volatility has been higher in 2022 compared to 2021 and this year has seen a divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities once again.

The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them to negative from stable.
There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weakening economic outlook and likely recessions in many regions increase the possibility of a deterioration in the quality of banks' assets, while higher interest rates provide a boost to net income and profitability. However, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

Approved counterparties – Credit Rated: SC maintains a restricted list of financial institutions to be used as counterparties, and in accordance with the credit criteria set out in appendix B. Any proposed additions to the list must be approved by the Section 151 Officer (Director of Finance & Governance).

Approved counterparties – Non-Credit Rated: As investment decisions are never made solely based on credit ratings, and some institutions may not have ratings at all, account will be taken of any relevant credit criteria in appendix B, and any other relevant factors including advice from our treasury advisors for the approval of individual institutions. Again, this will be specifically authorised by the Section 151 Officer (Director of Finance & Governance).

Credit rating: SC has constructed and will maintain a counterparty list based on the criteria set out in **Appendix B.** The minimum credit quality is proposed to be set at A- or equivalent. The credit standing of institutions (and issues if used) will be monitored and updated on a regular basis.

The Council will continuously monitor counterparties creditworthiness. All three credit rating agencies' websites will be visited frequently, and all ratings of proposed counterparties will be subject to verification on the day of investment (DLUHC guidance states that a credit rating agency is one of Standard & Poor's, Moody's Investor Services Ltd, and Fitch Ratings Ltd). All ratings of currently used counterparties will be reported to the regular treasury management meeting, where proposals for any new counterparties will be discussed.

New counterparties must be approved by the Section 151 Officer (Director of Finance & Governance) before they are used. Any changes to ratings that put the counterparty below the minimum acceptable credit quality whilst we have a deposit, or a marketable instrument will be brought to the attention of the Section 151 Officer (Director of Finance & Governance) immediately, and an appropriate response decided on a case-by-case basis. Sovereign credit ratings will be monitored and acted on as for financial institution ratings. Investment limits are set by reference to the lowest published long-term credit rating from the three rating agencies mentioned above. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

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 those outlined below.

- Credit Default Swaps and Government Bond Spreads.
- GDP and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Banking resolution mechanisms for the restructure of failing financial institutions, i.e. bail-in.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.
- Underlying securities or collateral for 'covered instruments'.
- Other macroeconomic factors

It remains the Council's policy to suspend or remove institutions that still meet criteria, but where any of the factors above give rise to concern. Also, when it is deemed prudent, the duration of deposits placed is shortened or lengthened, depending on counterparty specific metrics, or general investment factors.

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 for example, or with other local authorities. This will cause a reduction in the level of investment income earned but will protect the principal sum invested.

Investment limits: Investment limits are set out in **appendix B**. In setting criteria in **appendix B**, account is taken of both expected and possible balances, the availability and accessibility of the various instruments to be used, and their security, liquidity, and yield characteristics.

Liquidity management: The Council uses purpose-built cash flow forecasting software 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.

14 Treasury Management Prudential Indicators

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

The Authorised Limit and Operational Boundary are Prudential Indicators and are authorised by Full Council as part of the Capital Strategy. They are included here for information only. The 'Maturity Structure of Borrowing'', 'Principal sums invested for periods longer than a year', and 'Credit Risk' Indicators are specific Treasury Management Indicators and are to be adopted as per the recommendations set out in this paper.

Authorised limit and Operational Boundary: The Council is required to set an authorised limit and an operational boundary for external debt. The authorised limit is the maximum external debt (net of investments) that may be incurred in the specified years. The operational boundary differs from the authorised limit in that it is based on expectations of the maximum external debt according to probable, not all possible events. It is consistent with the maximum level of external debt projected in the Capital Strategy. In order that the preceding borrowing strategy can be carried out, the following Prudential Indicators have been proposed to Council in the Capital Strategy, along with Capital plans and the rationale behind the figures. They are shown again here to give the full picture. (These figures are rounded to the nearest million).

	2022/23 limit £m	**2023/24 limit £m**	**2024/25 limit £m**	**2025/26 limit £m**
Operational boundary – borrowing	N/A	1,004.4	1,013.1	1,015.7
Operational boundary – PFI and leases	N/A	79.3	78.0	76.7
Operational boundary – total external debt	**N/A**	**1,083.8**	**1,091.1**	**1,092.4**
Authorised limit – borrowing	**N/A**	1,039.4	1,048.1	1,050.7
Authorised limit – PFI and leases	**N/A**	84.3	83.0	81.7
Authorised limit– total external debt	**N/A**	**1,123.7**	**1,131.1**	**1,132.4**

Please note this includes General Fund and Housing Revenue Account

Maturity Structure of Borrowing: The Council has set for the forthcoming year, both the upper and lower limits with respect to the maturity structure of its borrowing. The calculation is the amount of projected borrowing maturing in each period, expressed as a percentage of the total projected borrowing. CIPFA TM Code guidance for the 'maturity structure' indicator states that the maturity of LOBO loans should be treated as if their next option date is the maturity date. The 'maturity structure of borrowing' indicators have been set with regard to this and having given due consideration to refinancing the significant short-term debt that will mature, possible new borrowing, current interest rate expectations, and the possibility of rescheduling or prematurely repaying loans outlined in the borrowing strategy. The bands and limits give the required flexibility to be able to deliver the borrowing strategy in any of the challenging scenarios that may evolve. They are: -

	Upper Limit	Lower Limit
Under 12 months	50%	15%
>12 months and within 24 months	25%	0%
>24 months and within 5 years	25%	5%
>5 years and within 10 years	25%	0%
>10 years and within 20 years	25%	0%
>20 years and within 30 years	20%	0%
>30 years and within 40 years	30%	10%
>40 years and within 50 years	15%	0%
>50 years	5%	0%

Long-term treasury management investments: 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 prime policy objectives of local authority investment activities are the security and liquidity of funds, and authorities should avoid exposing public funds to unnecessary or unquantified risk. Authorities should consider the return on their investments; however, this should not be at the expense of security and liquidity. It is therefore important that authorities adopt an appropriate approach to risk management with regards to their investment activities.

	2023-24	**2024-25**	**2025-26**
No Fixed Date			
Prudential Limit for principal sums	**£m**	**£m**	**£m**
invested for periods longer than 1 year	160	160	160

Long-term investments with no fixed maturity date include strategic pooled funds but exclude Money Market Funds and bank accounts with no fixed maturity as these are considered short-term. As the combined Council will already hold a portfolio of £144m of pooled funds, a prudential indicator of slightly more than this amount is deemed necessary for all years, to allow for deposits slightly over 1 year's duration. This may change after a review of the amalgamated portfolio. The sums indicated in this indicator do not include any investment in non-Treasury Investments covered by a separate Investment Strategy.

Credit Risk Indicator: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating / credit score of its in-house investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk (in conjunction with Arlingclose) and will be calculated quarterly.

Credit risk indicator	**Target**
Portfolio average credit rating (score)	A (6.0)

Liability Benchmark: A new Prudential Indicator, the Liability Benchmark has been introduced for 2023-24. Whilst it gives no specific numbers as benchmarks, it is an important tool to help establish whether the Council is likely to be a long-term borrower or long-term investor in the future, and so shape its strategic focus and decision making. The liability benchmark itself represents an estimate of the cumulative amount of external borrowing the Council must hold to fund its current capital and revenue plans while keeping treasury investments at the minimum level required to manage day-to-day cash flow.

The liability benchmark informs both borrowing and investment decisions and is outlined in section 13 under internal context.

15 Other Matters

The CIPFA TM Code requires the Council to include the following in its treasury management strategy.

Derivative Instruments: The code requires that the Council must explicitly state whether it plans to use derivative instruments to manage risks. The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). However, the Council does not intend to use derivatives.

Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require Full Council approval.

External Service Providers: The code states that external service providers should be reviewed regularly and that services provided are clearly documented, and that the quality of that service is controlled and understood.

The Council recognises, as per CIPFA guidance, that, "the overall responsibility for treasury management must always remain with the Council". So as not to place undue reliance on treasury advisors and other external services, the council has always sourced its own information, performed its own analysis of market and investment conditions, and the suitability of counterparties. It continues to do so through embedded practices, thereby maintaining the skills of the in-house team to ensure that services provided can be challenged, and that undue reliance is not placed on them.

Member Training: All public service organisations should be aware of the growing complexity of treasury management in general, and its application to the public services in particular. Modern treasury management, and particularly non-treasury investments demand appropriate skills.

The new Investment Strategy demands a greater level of understanding and involvement by members, and that document sets out the specific requirements for that purpose; However, there should still be an appropriate level of skills and understanding applied to the Treasury Management Strategy.

All Council Members receive introductory training, which includes an overview of the treasury management function. Council Officers would be able and willing to provide a more detailed level of training, if Councillors thought that there would be no conflict of interest.

Through contacts with the CIPFA Treasury Management Forum and its independent Treasury Advisors, SC could also facilitate training via an independent third party. Officers also have contacts within a number of money market brokers and fund managers who could provide training.

As and when needed, information sheets could be prepared and made available to help keep members abreast of current developments.

Markets in Financial Instruments Directive II (MiFID II): As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3rd January 2018 local authorities were automatically treated as retail clients but could "opt up" to professional client status, providing certain criteria was met. This included having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the Council have at least a year's relevant professional experience. In addition, the regulated financial services firms to whom this directive applies have had to assess that that person(s) have the expertise, experience and knowledge to make investment decisions and understand the risks involved. Each regulated Financial Services firm undertakes a separate assessment with ongoing compliance.

The Council continues to meet the conditions to opt up to professional status and has done so in order to maintain its erstwhile MiFID II status prior to January 2018. As a result, the Council will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

16 Background papers

Local Government Act 2003 – Guidance under section 15(1)(a) 3rd Edition, effective from 1 April 2018.

The CIPFA 'Treasury Management in the Public Services' Code of Practice Revised Edition 2021.

The CIPFA Prudential Code for Capital Finance in Local Authorities: Revised Edition 2021.

Note: For sight of individual background papers please contact the report author.

Report Sign-Off

		Signed-off
Legal Implications	Honor Clarke	
Governance	Scott Wooldridge	
Corporate Finance	Jason Vaughan	
Human Resources	Chris Squire	
Property	Paula Hewitt / Oliver Woodhams	
Procurement / ICT		
Senior Manager	Stephen Morton / Donna Parham	23/1
Commissioning Development	Sunita Mills / Ryszard Rusinek	23/1
Renewal Board		
Local Member	N/A	
Executive Member	Cllr Liz Leyshon - Executive Member for Resources	
Opposition Spokesperson	Cllr Mandy Chilcott	
Scrutiny Chair	Cllr Gwil Wren	
Audit Committee	Cllr Dean Ruddle	

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Appendix A

Treasury Management Policy Statement

Introduction and Background

1.1 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the code), as described in Section 5 of the Code

1.2 The Council will create and maintain, as the cornerstones for effective treasury and investment management:

- A treasury management policy statement stating the policies, objectives and approach to risk management of its treasury management activities
- Suitable treasury management practices (TMPs) setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities
- Investment management practices (IMPs) for investments that are not for treasury management purposes.

The content of the policy statement, TMPs and IMPs will follow the recommendations contained in Sections 6, 7 and 8 of the TM Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the TM Code's key principles.

1.3 The Council (ie Full Council) will receive reports on its treasury and investment management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close in the form prescribed in its TMPs and IMPs.

1.4 The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Executive and for the execution and administration of treasury management decisions to the Section 151 Officer, who will act in accordance with the organisation's policy statement, TMPs and IMPs, and if they are a CIPFA member, CIPFA's Standard of Professional Practice on treasury management.

1.5 This organisation nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Policies and Objectives of Treasury Management Activities

2.1 The Council defines its treasury management activities as:

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

2.2 This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

2.3 This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

2.4 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken, and the type of borrowing should allow the Council transparency and control over its debt.

2.5 The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yield earned on investments remain important but are secondary considerations.

Appendix B

Somerset Council Lending Counterparty Criteria 2023-24

The following criteria will be used to manage counterparty risks to Somerset Council investments for new deposits / investments from 1st April 2023.

Please note that the limits in this appendix apply only to Treasury Management Investments, not to those detailed in the Separate Investment Strategy.

Where deposits held were made under previous criteria, there will be no compulsion to terminate those deposits to meet new criteria, where a penalty would be incurred.

Deposits
Any Financial Institution that is authorised by the Prudential Regulation Authority to accept deposits in the UK, or is a UK Building Society can be lent to, subject to the rating criteria below at the time of the deposit.

Unrated Building Societies
Unrated Building Societies as identified by Treasury Advisors can be used, with a maximum of £1m per Society and a maximum maturity of 1 year.

Marketable Instruments – Any bank, other organisation, or security whose credit ratings satisfy the criteria below: -

Rating of Counterparty or Security
<u>Deposits or instruments of less than 13 months duration (refer to long-term ratings)</u>
Fitch A- or above
S&P A- or above
Moody's A3 or above

The maximum deposit / investment amount for any authorised counterparty or security that has as a minimum at least two ratings of the three above will be £20m. This is approximately 4.4% of investment balances held at 30th September, or 6.5% of investment balances minus strategic funds held at 30th September. The % may be significantly less if borrowing up to the CFR is taken early in the year.

The maximum deposit / investment amount for any authorised counterparty or security that has as a minimum - Fitch AA-, S&P AA-, and Moody's Aa3, will be £25m. This is approximately 5.5% of investment balances held at 30th September, or 8.1% of investment balances minus strategic funds held at 30th September. The % may be significantly less if borrowing up to the CFR is taken early in the year.

Deposits or instruments of more than 13 months duration (refer to long-term ratings)
Fitch AA- or above
S&P AA- or above
Moody's Aa3 or above

The maximum deposit / investment amount for more than 13 months for any authorised counterparty or security that has as a minimum at least two ratings of the three above will be £10m. This figure is to be included in the overall figure above.

The allowed deposit amounts above are the single maximum per counterparty at any one time, and that counterparty or security must be rated as above or better by at least two of the three agencies. Short-term ratings will be monitored and considered in relative rather than absolute terms.

It remains the Council's policy to suspend or remove institutions that still meet criteria, but where any of the other factors below give rise to concern. Also, when it is deemed prudent, the duration of deposits placed is shortened or lengthened, depending on counterparty specific metrics, or general investment factors.
Where deposits held were made under previous criteria, there will be no compulsion to terminate those deposits to meet new criteria, where a penalty would be incurred.

Operational Bank Accounts
As the Council's current bankers, Nat West are currently within the minimum criteria. If they should fall below criteria, the instant access Call Account facility may still be used for short-term liquidity requirements and business continuity arrangements. This will generally be for smaller balances where it is not viable to send to other counterparties or in the event of unexpected receipts after the daily investment process is complete. Money will be placed in the instant access Nat West call account overnight.

Public Sector Bodies
Any UK Local Authority or Public Body will have a limit of £15m and a maximum maturity of 5 years.

The UK Government, including Gilts, T-Bills, and the Debt Management Office (DMADF) will be unlimited in amount and duration.

The table below gives a definition and approximate comparison of various ratings by the three main agencies: -

Definitions of Rating Agency Ratings

	Fitch		Moody's		S&P	
Short-Term	F1+	Exceptionally strong	P-1	Superior	A-1+	Extremely strong
	F1	Highest quality			A-1	Strong
	F2	Good quality	P-2	Strong	A-2	Satisfactory
	F3	Fair quality	P-3	Acceptable	A-3	Adequate
	B	Speculative	NP	Questionable	B and below	Significant speculative characteristics
	C	High default risk				
	(+) or (-)		(1,2, or 3)		(+) or (-)	
Long-Term	AAA	Highest quality	Aaa	Exceptional	AAA	Extremely strong
	AA	V High quality	Aa	Excellent	AA	Very strong
	A	High quality	A	Good	A	Strong
	BBB	Good quality	Baa	Adequate	BBB	Adequate capacity
	BB	Speculative	Ba	Questionable	BB and below	Significant speculative characteristics
	B	Highly Speculative	B	Poor		
	CCC	High default risk	Caa	Extremely poor		

Financial Groups
For Financial Groups (where two or more separate counterparties are owned by the same eventual parent company) investments can be split between entities, but an overall limit equal to the highest rated constituent counterparty within the group will be used.

Country Limits
Excluding the UK, there will be a limit of £30m. This is approximately 6.6% of investment balances held at 30th September, or 9.7% of investment balances minus strategic funds held at 30th September. The % may be significantly less if borrowing up to the CFR is taken early in the year.

Money Market Funds
Any LVNAV Mpney Market Fund used must be rated by at least two of the main three ratings agency, and must have the following ratings.

Fitch AAAmmf	Moody's Aaa-mf	Standard & Poor's AAAm

Subject to the above, deposits can be made with the following limits: -
The lower of £15m or 0.5% of the total value for individual Funds.
No more than 50% of total deposits outstanding are to be held in LVNAV MMFs.

VNAV and other Pooled Funds
Currently, not all Variable Net Asset Value (VNAV) Funds carry a rating. Many VNAV bond funds are not rated. Equity, multi-asset and property funds are also not credit rated.

A full review of Pooled Funds after the amalgamation of the five Council's portfolios will determine strategy and investment in these longer-term assets. It is the Council's intention to not invest further in Pooled Funds until the review is complete.

It is Somerset Council's ambition that any strategic investments within the treasury assets in pooled funds invested in bonds/equities or property would be held exclusively against general and earmarked reserves of the Council or cash and the Council will not borrow or use existing debt to support such investments. Depending on the position inherited from the 5 predecessor Councils a period of adjustment may be needed to realise this ambition and consideration must be given to waiting for the correct pricing point to obtain best value for the Council.

The decision to stay invested / invest further / disinvest / rebalance the Pooled Funds portfolio will be primarily based on the liability benchmark, and specifically whether the duration of debt and the necessary level of reserves supports longer-term investments. As potential investment would lock away capital for 3 to 5-years plus, the level of prudent investment would be commensurate with the level of core balances and reserves available for/during that timeframe.

Diversification of asset classes/funds and the overall level of investment will be determined by the Section 151 Officer with reference to the level of core balances and reserves. Secondly, it will consider the evaluation of the risk/reward characteristics including volatility, expected income return and potential for capital growth of individual funds.

It may be decided that a percentage of core balances and reserves is deemed the most appropriate limit for Pooled Funds, but in any case, this will not exceed the £144.3m in total currently held, or £20m in any one fund. (with the exception of the amalgamated CCLA Property Fund holding which is £31m).

Other Indicators

The Council will continue to use a range of indicators, not just credit ratings. Among other indicators to be taken into account will be:

- Credit Default Swaps and Government Bond Spreads.
- GDP, and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Banking resolution mechanisms for the restructure of failing financial institutions, i.e. bail-in.
- Share Price.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.
- Underlying securities or collateral for covered instruments.
- Other macroeconomic factors

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Appendix C

Arlingclose Economic Outlook & Interest Rate Forecast

Interest rate forecast:

- The MPC remains concerned about inflation but sees the path for Bank Rate to be below that priced into markets.

- Following the exceptional 75bp rise in November, Arlingclose believes the MPC will slow the rate of increase at the next few meetings. Arlingclose now expects Bank Rate to peak at 4.25%, with a further 50bp rise in December and smaller rises in 2023.

- The UK economy likely entered into recession in Q3, which will continue for some time. Once inflation has fallen from the peak, the MPC will cut Bank Rate.

- Arlingclose expects gilt yields to remain broadly steady despite the MPC's attempt to push down on interest rate expectations. Without a weakening in the inflation outlook, investors will price in higher inflation expectations given signs of a softer monetary policy stance.

- Gilt yields face pressures to both sides from hawkish US/EZ central bank policy on one hand, to the weak global economic outlook on the other. BoE bond sales will maintain yields at a higher level than would otherwise be the case.

	Current	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25
Official Bank Rate													
Upside risk	0.00	0.25	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25
Arlingclose Central Case	3.00	3.50	4.00	4.25	4.25	4.25	4.25	4.00	3.75	3.50	3.50	3.50	3.50
Downside risk	0.00	0.25	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00
3-month money market rate													
Upside risk	0.00	0.25	0.50	0.75	1.00	1.00	1.00	1.25	1.50	1.75	1.50	1.25	1.25
Arlingclose Central Case	3.00	3.90	4.40	4.40	4.40	4.35	4.30	4.25	4.00	3.75	3.75	3.75	3.75
Downside risk	0.00	0.25	0.50	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00
5yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.36	3.65	3.90	3.90	3.90	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
10yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.46	3.70	3.75	3.75	3.75	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
20yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.88	4.00	4.00	4.00	4.00	4.00	3.90	3.90	3.90	3.90	3.90	3.90	3.90
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
50yr gilt yield													
Upside risk	0.00	0.60	0.70	0.80	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Arlingclose Central Case	3.24	3.40	3.40	3.40	3.40	3.40	3.30	3.30	3.30	3.30	3.30	3.30	3.30
Downside risk	0.00	0.70	0.90	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
UKIB Rate (Maturity Loans) = Gilt yield + 0.60%

Underlying assumptions:

- UK interest rate expectations have eased following the Autumn Statement, with a growing expectation that UK fiscal policy will now be tightened to restore investor confidence, adding to the pressure on household finances. The peak for UK interest rates will therefore be lower, although the path for interest rates and gilt yields remains highly uncertain.

- Globally, economic growth is slowing as inflation and tighter monetary policy depress activity. Inflation, however, continues to run hot, raising expectations that policymakers, particularly in the US, will err on the side of caution, continue to increase rates and tighten economies into recession.

- The new Chancellor dismantled the mini-budget, calming bond markets and broadly removing the premium evident since the first Tory leadership election. Support for retail energy bills will be less generous, causing a lower but more prolonged peak in inflation. This will have ramifications for both growth and inflation expectations.

- The UK economy is already experiencing recessionary conditions, with business activity and household spending falling. Tighter monetary and fiscal policy, alongside high inflation will bear down on household disposable income. The short- to medium-term outlook for the UK economy is bleak, with the BoE projecting a protracted recession.

- Demand for labour remains strong, although there are some signs of easing. The decline in the active workforce has fed through into higher wage growth, which could prolong higher inflation. The development of the UK labour market will be a key influence on MPC decisions. It is difficult to see labour market strength remaining given the current economic outlook.

- Global bond yields have steadied somewhat as attention turns towards a possible turning point in US monetary policy. Stubborn US inflation and strong labour markets mean that the Federal Reserve remains hawkish, creating inflationary risks for other central banks breaking ranks.

- However, in a departure from Fed and ECB policy, in November the BoE attempted to explicitly talk down interest rate expectations, underlining the damage current market expectations will do to the UK economy, and the probable resulting inflation undershoot in the medium term. This did not stop the Governor affirming that there will be further rises in Bank Rate.

SOMERSET COUNTY COUNCIL

TREASURY MANAGEMENT PRACTICES

Version 6: January 2020

Approved by Section 151 Officer

Sheila Collins .... **Date**. 23 January 2020

Approved by Deputy Section 151 Officer

J. C. Vaughan .... **Date**. 23/1/2020

Introduction

The CIPFA Code of Practice on Treasury Management in the Public Services (the Code) was last revised in December 2017. The Code requires setting out the responsibilities and duties of members and officers, allowing a framework for reporting and decision making on all aspects of treasury management. There is now no longer a requirement to formally adopt the Treasury Management Code, but instead the Council is now required by law to have regard to the Code. Treasury Management is defined by CIPFA as

> **'The management of the Authority's investments, cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with these activities; and the pursuit of optimum performance consistent with those risks'.**

The Ministry of Housing, Communities and Local Government (MHCLG) published revised statutory guidance and an informal commentary on Local Authority Investments for England in February 2018.

'Investments' now covers all the financial assets of the Council, as well as other non-financial assets which the Council holds primarily or partially for financial returns, including but not limited to investment property portfolios. Such non-financial assets are not managed as part of the Council's normal treasury management or under treasury management delegations, but they nonetheless require appropriate investment and risk management under the Code. An outline Treasury Management Practice (TMP 13) is included in this document but would be enhanced and more detailed to specific Non-Treasury investments if they were to be considered.

The Code identifies three key principles

(1) Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities

(2) Their policies and practices should make clear that the effective management and control of risk and prime objectives of their treasury management activities and that responsibility for these lies clearly within these organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and portfolio liquidity when investing treasury management funds

(3) They should acknowledge that the pursuit for value for money in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this

CIPFA recommends that all public service organisations adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances, the following four clauses.

(1) The Council will create and maintain, as the cornerstones for effective treasury management

   a. A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities

   b. Suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities

   The content of the policy statement and TMPs will follow the recommendations contained in Section 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of the Council. Such amendments will not result in the organisation materially deviating from the Code's key principles.

(2) The Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

(3) The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Cabinet, and for the execution and administration of treasury management decisions to the Section 151Officer, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management

(4) The Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of treasury management strategy and policies

The Treasury Management Practices (TMPs) comprise:

TMP1	Risk management
TMP2	Performance measurement
TMP3	Decision making and analysis
TMP4	Approved instruments, methods and techniques
TMP5	Organisation, clarity and segregation of responsibilities, and dealing arrangements
TMP6	Reporting requirements and management information arrangements
TMP7	Budgeting, accounting and audit arrangements
TMP8	Cash and cash flow management
TMP9	Money laundering
TMP10	Training and qualifications
TMP11	Use of external service providers
TMP12	Corporate governance

TMP 13 Non-Treasury Investments (Investments that are not part of Treasury Management Activity) – There are currently no plans for Non-Treasury Investments, and it would be impracticable to cover all possibilities and eventualities at this stage. If Non-Treasury Investments were to be pursued, a suitable TMP would be developed as part of the governance process.

Schedules supporting these practices and other documents held at an operational level specify the systems and routines to be employed and the records to be maintained in fulfilling the Council's treasury functions.

Each of the thirteen Treasury Management Practices is set out on the following pages, and fuller notes are provided in Schedules A to M, where it is felt that more detailed information would be helpful, or to explain how each of the Practices is managed.

Whilst it is envisaged that the Treasury Management Practices will not change unless CIPFA's guidance were to be amended, the notes in the Schedules will be subject to regular review and amended where necessary in line with new regulation, guidance, market developments, or any other factors which may from time to time affect the operations of the treasury management function. Any suggested amendments will be brought to a monthly treasury management meeting, and will be ratified by the Section 151 Officer

Sheila Collins
Director of Finance (Section 151 Officer)

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SCHEDULES TO THE TREASURY MANAGEMENT PRACTICES

TMP1 RISK MANAGEMENT

General statement

The responsible officer, currently the Director of Finance (Section 151 Officer), will design, implement and monitor all arrangements for the identification, management and control of treasury management risk, will report at least semi-annually on the adequacy/suitability thereof, and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the organisation's objectives in this respect, all in accordance with the procedures set out in TMP6 *Reporting requirements and management information arrangements*.

In respect of each of the following risks, the arrangements, which seek to ensure compliance with these objectives, are set out in the schedule to this document.

[1] Credit and counterparty risk management

SCC regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that robust due diligence procedures cover all external investments. Its counterparty lists and limits will reflect a prudent attitude towards organisations with which funds may be deposited, and will limit its investment activities to the instruments, methods and techniques referred to in TMP4 *Approved instruments methods and techniques* and listed in the schedule to this document. It also recognises the need to have, and will therefore maintain, a formal counterparty policy in respect of those organisations from which it may borrow, or with whom it may enter into other financing or derivative arrangements.

[2] Liquidity risk management

SCC will ensure it has adequate though not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives.

SCC will only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities.

[3] Interest rate risk management

SCC will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements as amended in accordance with TMP6 *Reporting requirements and management information arrangements*.

It will achieve this by the prudent use of its approved instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates. This should be subject to the consideration and, if required, approval of any policy or budgetary implications.

It will ensure that any hedging tools such as derivatives are only used for the management of risk and the prudent management of financial affairs and that the policy for the use of derivatives is clearly detailed in the annual strategy.

[4] Exchange rate risk management

It will manage its exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income/expenditure levels.

[5] Inflation risk management

SCC will keep under review the sensitivity of its treasury assets and liabilities to inflation and will seek to manage the risk accordingly in the context of the whole organisation's inflation exposures.

[6] Refinancing risk management

SCC will ensure that its borrowing, private financing and partnership arrangements are negotiated, structured and documented, and the maturity profile of the monies so raised are managed, with a view to obtaining offer terms for renewal or refinancing, if required, which are competitive and as favourable to the organisation as can reasonably be achieved in the light of market conditions prevailing at the time.

It will actively manage its relationships with its counterparties in these transactions in such a manner as to secure this objective and will avoid over reliance on any one source of funding if this might jeopardise achievement of the above.

[7] Legal and regulatory risk management

SCC will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities. In framing its credit and counterparty policy under TMP1 [1] *Credit and counterparty risk management*, it will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the transactions they may affect with the organisation, particularly with regard to duty of care and fees charged.

SCC recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the organisation.

[8] Fraud, error and corruption, and contingency management

SCC will ensure that it has identified the circumstances, which may expose it to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings. Accordingly, it will employ suitable systems and procedures, and will maintain effective contingency management arrangements, to these ends.

[9] Market risk management

SCC will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests and will accordingly seek to protect itself from the effects of such fluctuations.

TMP2 Performance measurement

SCC is committed to the pursuit of value for money in its treasury management activities, and to the use of performance methodology in support of that aim, within the framework set out in its treasury management policy statement.

Accordingly, the treasury management function will be the subject of ongoing analysis of the value it adds in support of the organisation's stated business or service objectives. It will be the subject of regular examination of alternative methods of service delivery, of the availability of fiscal or other grant or subsidy incentives, and of the scope for other potential improvements. The performance of the treasury management function will be measured using the criteria set out in the schedule to this document.

TMP3 Decision-making and analysis

SCC will maintain full records of its treasury management decisions, and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past, and for demonstrating that reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at the time.

The guidance on decision making states that relevant due diligence should take place on all transactions. In respect of all investment decisions SCC will consider the risks to capital and returns and the implications for future plans and budgets.

The issues to be addressed and processes and practices to be pursued in reaching decisions are detailed in the schedule to this document.

TMP4 Approved instruments, methods and techniques

SCC will undertake its treasury management activities by employing only those instruments, methods and techniques detailed in the schedule to this document, and within the limits and parameters defined in TMP1 *Risk management.*

Where SCC intends to use derivative instruments for the management of risks, these will be limited to those set out in its annual treasury strategy. SCC will seek proper advice and will consider that advice when entering into arrangements to use such products to ensure that it fully understands those products.

The consideration of skills and experience is particularly critical where organisations request to be treated as professional clients under MIFID II. Designation under MIFID II should be endorsed by the treasury management strategy and regularly reviewed to ensure that designation remains appropriate. SCC with current practitioners is designated as a 'Professional' client.

TMP5 Organisation, clarity and segregation of responsibilities, and dealing arrangements.

SCC considers it essential, for the purposes of the effective control and monitoring of its treasury management activities, for the reduction of the risk of fraud or error, and for the pursuit of optimum performance, that these activities are structured and managed in a fully integrated manner, and that there is at all times a clarity of treasury management responsibilities.

The principle on which this will be based is a clear distinction between those charged with setting treasury management policies and those charged with implementing and controlling these policies, particularly with regard to the execution and transmission of funds, the recording and administering of treasury management decisions, and the audit and review of the treasury management function.

If and when SCC intends, as a result of lack of resources or other circumstances, to depart from these principles, the Section 151 Officer will ensure that the reasons are properly reported in accordance with TMP6 *Reporting requirements and management information arrangements*, and the implications properly considered and evaluated.

The Section 151 Officer will ensure that there are clear written statements of the responsibilities for each post engaged in treasury management, and the arrangements for absence cover. The Section 151 Officer will also ensure that at all times those engaged in treasury management will follow the policies and procedures set out. The present arrangements are detailed in the schedule to this document.

The Section 151 Officer will ensure there is proper documentation for all deals and transactions, and that procedures exist for the effective transmission of funds. The present arrangements are detailed in the schedule to this document.

The delegations to the Section 151 Officer in respect of treasury management are set out in the schedule to this document. The Section 151 Officer will fulfill all such responsibilities in accordance with the organisation's policy statement and TMPs and, if a CIPFA member, the *Standard of Professional Practice on Treasury Management.*

TMP6 Reporting requirements and management information arrangements

SCC will ensure that regular reports are prepared and considered on the implementation of its treasury management policies; on the effects of decisions taken and transactions executed in pursuit of those policies; on the implications of changes, particularly budgetary, resulting from regulatory, economic, market or other factors affecting its treasury management activities; and on the performance of the treasury management function.

As a minimum:
SCC (i.e. Full Council) will receive: -

- An annual report on the strategy and plan to be pursued in the coming year
- A mid-year review
- An annual report on the performance of the treasury management function, on the effects of the decisions taken and the transactions executed in the past year, and on any circumstances of non-compliance with the SCC treasury management policy statement and TMPs.

The Senior Management Team will receive regular (monthly) monitoring reports on treasury management activities and risks.

The Audit Committee will have responsibility for the scrutiny of treasury management policies and practices.

SCC will report the treasury management indicators as detailed in the TM Codes sector specific guidance notes.

The present arrangements and the form of these reports are detailed in the schedule to this document.

TMP7 Budgeting, accounting and audit arrangements

The Section 151 Officer will prepare, SCC will approve and, if necessary, from time to time amend an annual budget for treasury management, which will bring together all of the costs involved in running the treasury management function, together with associated income. The matters to be included in the budget will at minimum be those required by statute or regulation, together with such information as will demonstrate compliance with TMP1 *Risk management*, TMP2 *Performance measurement,* and TMP4 *Approved instruments, methods and techniques.*

The Section 151 Officer will exercise effective controls over this budget and will report upon and recommend any changes required in accordance with TMP6 *Reporting requirements and management information arrangements.*

SCC will account for its treasury management activities, for decisions made and transactions executed, in accordance with appropriate accounting practices and standards, and with statutory and regulatory requirements in force for the time being.

SCC will ensure that its auditors, and those charged with regulatory review, have access to all information and papers supporting the activities of the treasury management function as are necessary for the proper fulfilment of their roles, and that such information and papers demonstrate compliance with external and internal policies and approved practices.

TMP8 Cash and cash flow management

Unless statutory or regulatory requirements demand otherwise, all monies in the hands of SCC will be under the control of the Section 151 Officer and will be aggregated for cash flow and investment management purposes. Cash flow projections will be prepared on a regular and timely basis, and the Section 151 Officer will ensure that these are adequate for the purposes of monitoring compliance with TMP1 [2] *Liquidity risk management.*

The present arrangements for preparing cash flow projections, and their form, are set out in the schedule to this document.

TMP9 Money laundering

SCC is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure that staff involved in this, are properly trained. The present arrangements, including the name of the officer to whom reports should be made, are detailed in the schedule to this document.

TMP10 Training and qualifications

SCC recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The Section 151 Officer will recommend and implement the necessary arrangements.

The Section 151 Officer will ensure that Council members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.

Those charged with governance recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively. The present arrangements are detailed in the schedule to this document.

TMP11 Use of external service providers

SCC recognises that responsibility for treasury management decisions always remains with the Council. It recognises that there may be potential value in employing external providers of treasury management services, in order to acquire access to specialist skills and resources. When it employs such service providers, it will ensure it does so for reasons, which have been submitted to a full evaluation of the costs and benefits. It will also ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented and subjected to regular review. And it will ensure, where feasible and necessary, that a spread of service providers is used, to avoid over-reliance on one or a small number of companies.

Where services are subject to formal tender or re-tender arrangements, legislative requirements will always be observed. The monitoring of such arrangements rests with the Section 151 Officer, and details of the current arrangements are set out in the schedule to this document.

TMP12 Corporate governance

SCC is committed to the pursuit of proper corporate governance throughout its businesses and services, and to establishing the principles and practices by which this can be achieved. Accordingly, the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.

SCC has adopted and has implemented the key principles of the TM Code. This, together with the other arrangements detailed in the schedule to this document, are considered vital to the achievement of proper corporate governance in treasury management, and the Section 151 Officer will monitor and, if and when necessary, report upon the effectiveness of these arrangements.

TMP13 Investments that are not part of Treasury Management Activity

SCC recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes, requires careful investment management. Such activity includes loans supporting service outcomes, investments in subsidiaries, and investment property portfolios.

SCC will ensure that all its investments are covered in the Capital Strategy, Investment strategy or equivalent, and will set out, where relevant, the Council's risk appetite and specific policies and arrangements for non-treasury investments. It is recognised that the risk appetite for these activities may differ from that for treasury management.

SCC recognises that many of the principles underlying TMPs 1 to 12 will apply to non-treasury investments as they do to treasury investments. However, some aspects are likely to differ significantly. It is impracticable to cover all non-treasury investment eventualities in a schedule, so at the point where Investments that are not part of Treasury Management activity are being actively considered, a detailed TMP schedule will be developed to accurately reflect the risks and mitigating actions of the investment(s) being considered.

1.1 Credit and counterparty risk management

Credit and counter-party risk is the risk of failure by a third party to meet its contractual obligations under an investment, loan or other commitment, especially one due to deterioration in its creditworthiness, which causes the Council an unexpected burden on its capital or revenue resources.

As a holder of public funds, the Council recognises its responsibility to the prudent management of public funds and follows relevant Government guidance. The Office of the Deputy Prime Minister, (now Communities and Local Government) issued guidance on Local Government Investments under section 15(1) of the LGA 2003. This has been revised and revisions are effective from 1st April 2018. The overriding aim of the guidance is to encourage authorities to invest prudently, without burdening them with detailed prescriptive regulation.

The guidance defines a prudent investment policy as having two objectives: achieving first of all security (protecting the capital sum from loss) and then liquidity (keeping the money readily available for expenditure when needed). The generation of investment income is distinct from these prudential objectives and is accordingly not a matter for the guidance. However, that does not mean that authorities are recommended to ignore such potential revenues. Provided that proper levels of security and liquidity are achieved, it may then (but only then) be reasonable to seek the highest yield consistent with those priorities. This widely-recognised investment policy is sometimes more informally and memorably expressed as follows:

Security - Liquidity -Yield *...in that order!*

Consequently, SCC will seek to optimise returns commensurate with the management of the associated risks.

1.1.1 Criteria to be used for creating and managing an approved counterparty list and limits

The Director of Finance (Section 151 Officer) will formulate suitable criteria for assessing and monitoring the credit risk of investment counterparties and shall construct criteria comprising time, type, sector and specific counterparty limits.

Treasury Advisors will provide guidance and assistance in setting the criteria.

Members will approve criteria at least annually, as part of the Treasury Management Strategy (TMS).

Credit ratings remain a key source of information, but it is important to recognise that they do have limitations. Credit ratings are only used as a starting point when considering credit risk.

Officers will use credit rating criteria in order to assist selection of creditworthy counterparties for placing investments with. Credit ratings will be used as sourced from all of the following credit rating agencies: -

Fitch Ratings
Moody's
Standard & Poor's

The Council will use ratings and information from all three ratings agencies where available (some institutions are only rated by one agency, some by two, some by all three), as part of its counterparty criteria.

SCC will remain vigilant to changes in ratings, with reference to information available on the website of the three rating agencies and other sources. All ratings for any proposed counterparty will be verified on the day, before any investment is made. The only exception to this will be when an additional deposit of less than £5m is made to an existing call, or money market fund account.

If a downgrade results in the counterparty or investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately. Changes to ratings of current and most often used counterparties are also highlighted at the monthly TM meeting. Any changes to ratings that put the counterparty below the rating criteria whilst they hold a deposit will be brought to the attention of the Director of Finance (Section 151 Officer) immediately, with an appropriate response decided on a case-by-case basis.

If any counterparty is placed on Rating Watch Negative, further deposits will be suspended until the reasons have been established. Further action will depend on the current rating and possible re-rating. This will be closely monitored with an appropriate response decided on a case-by-case basis.

Sovereign credit ratings will be monitored and acted on as for financial institution ratings.

Current counterparty criteria can be found in TMS and appendix B to the TMS that is agreed by Full Council each year.

1.1.2 Approved methodology for changing limits and adding/removing counterparties

All ratings of currently approved counterparties are reported at the monthly TM meeting. Proposals for any new counterparties will be discussed and agreed at this meeting. Email confirmation, or a letter to the counterparty will be obtained from the Director of Finance (Section 151 Officer), and the decision recorded in the minutes of the meeting. Limits are approved annually as part of the AIS and any revision to these would require Full Council approval.

1.1.3 List of approved counterparties and date of formal approval

In order to ensure that the approved counterparty list is at all times up to date, a separate schedule will be kept (Schedule N). As soon as a change is authorised by the Director of Finance (Section 151 Officer), this will be updated.

1.1.4 Country, sector, and group listings and limits

These form part of the TMS and appendix B to the TMS that is approved by Full Council each year. **1.1.5 Use of credit rating agencies' services**

SCC is a registered user of all three stated rating agency websites. It does not subscribe to the detailed research element, but has free access to all ratings, and notification of ratings changes.

1.1.6 Use of other sources of information for risk assessment

To supplement information from ratings agencies, relevant information from various publications is continuously garnered and assessed to help build a bigger picture, to help identify generic and specific counterparty risk.

As had previously been the case with SCC and is now a requirement of the revised CLG guidance, SCC will use a range of indicators to assess counterparties, not just credit ratings. Among other indicators to be taken into account will be: -

- Credit Default Swaps and Government Bond Spreads.
- GDP, and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Banking resolution mechanisms for the restructure of failing financial institutions, i.e. bail-in.
- Share Price of listed institutions.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.
- Underlying securities or collateral for 'covered instruments'
- Other macroeconomic factors

Supplementary information is sourced daily by reference to the quality press, Internet sources, Bloomberg terminals, and emails from broking and investment houses. There is also regular ongoing contact with a panel of money market brokers, money market fund managers, and other investment industry specialists.

1.2 Liquidity risk management

Liquidity risk is the risk that cash will not be available when it is required. This can jeopardise the ability of SCC to carry out its functions or disrupt those functions being carried out in the most cost-effective manner. The Director of Finance (Section 151 Officer) will therefore have sufficient standby facilities to ensure that there is always sufficient liquidity to deal with unexpected occurrences. He will also seek to ensure that SCC cash flow forecasting gives as accurate a picture as possible of the movement and timing of income and expenditure and the resulting residual daily cash balances.

1.2.1 Amounts of approved minimum cash balances and short-term investments

The Treasury Management section shall seek to minimise the balance held in the Council's main bank accounts at the close of each working day. Borrowing, calling on Call A/c or Money Market Fund balances, or lending shall be arranged in order to achieve this aim.

1.2.2 The County Council has the following facilities available: -

- Standby facilities – SCC operates a number of call accounts, each with differing features in relation to minimum balances to be maintained, number of permitted withdrawals during certain periods, and rates paid. SCC will retain balances within these accounts only when it is more advantageous than placing them on short-term deposits.

- Bank overdraft arrangements - An overdraft at 1.75% over base rate has been agreed as part of the banking services contract. The overdraft is assessed on a group basis for the Council's accounts and is agreed annually via a formal document signed by the Director of Finance (Section 151 Officer).

- Short-term borrowing facilities - The Council can access temporary loans through approved brokers on the London money market.

- Insurance/guarantee facilities - There are no specific insurance or guarantee facilities as the above arrangements are regarded as being adequate to cover all unforeseen occurrences.

1.2.3 Policy on borrowing in advance of need

The overriding objective for all approved borrowing is that it will be carried out in line with the CIPFA TM Code, i.e. that performance measurement should consider risk as well as return (borrowing rate). Priority will be given to risk management, and then the pursuit of minimising rate. There are many circumstances that may force borrowing at rates higher than the lowest achievable rate but may be directly attributable to good risk management or differing risk tolerances. These may include: -

- Taking loans of a stated maturity regardless of rate to ensure the desired maturity profile and thereby reduce refinancing risk.
- Taking Lender's Options Borrower's Option (LOBO) loans with greater regard to the structure rather than the cheapest rate where optionality exposes the Authority to refinancing, liquidity, and interest rate risk.
- Taking LOBO loans that dovetail with existing LOBO optionality.
- It may not be policy to borrow in advance of need even though it may be generally accepted that rates will go higher in the near future.
- It may be prudent to wait until capital expenditure has been incurred before loans are taken, even though rates may increase in the interim.

Actual borrowing undertaken and the timing will depend on timing of income and capital expenditure, interest rate forecasts, and market conditions during any given year. This may include borrowing in advance if after suitable risk analysis (including evaluating the cost of carry), market conditions and interest rates are deemed advantageous at that time. The short-term investment of these monies, until they are needed, will follow the same rigorous policies and criteria as the rest of the Council's investment balances.

1.3 Interest rate risk management

1.3.1 Interest Rate Monitoring

Interest rate risk is the risk that unexpected changes in interest rates expose the Council to greater costs or a shortfall in the income contained in the annual estimates. The Director of Finance (Section 151 Officer) will seek to minimise this risk by continuously monitoring interest rates, and particularly the economic indicators that influence their movement. As well as daily contact with a number of brokers, the opinions of expert analysts are sourced through various market publications.

The direction and timing of potential interest movements and their implications for SCC are discussed at the monthly TM meeting. A 'house view' is then taken and recorded in the minutes.

1.3.2 Interest Rate Strategy

Appropriate strategy, limits and trigger points are set in light of interest rate expectations and are incorporated into the Treasury Management Strategy Strategy, limits, and trigger points will be monitored during the relevant year to identify whether modifications are required in light of actual movements in interest rates.

The proportion of fixed and variable rate debt will be determined as part of the annual borrowing strategy to address the issues of affordability but without compromising the longer-term stability of the debt portfolio. The proportion will be kept under review on a regular basis.

SCC may determine it is more cost effective in the short-term to fund its borrowing requirement through the use of internal resources ('internal borrowing') or short-term loans. The benefits of such borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing or refinancing in future years when interest rates are expected to be higher.

Alternatively, SCC may consider forward starting loans where the interest rate is agreed and fixed in advance, but the cash is received in later years. This would enable certainty of cost be achieved without suffering a 'cost of carry' in the intervening period.

1.3.3 Trigger points for borrowing/investments

Trigger points and other guidelines for taking advantage of changes to interest rate levels are discussed at the TM monthly meeting and decisions are recorded in the minutes.

Officers will review the Treasury Management Strategy during the year to see whether any modifications are required in the light of actual movements in interest rates.

1.3.4 Policies concerning the use of instruments for interest rate management

- Forward dealing - Consideration will be given to dealing from forward periods dependent upon market conditions. When forward dealing is more than three months forward, the approval of the Director of Finance (Section 151 Officer) is required.

- Structured Investments - The Council may use Callable deposits, Snowballs, Escalators, Range Trades, or other such structured investments as it deems prudent, as part of its overall investment portfolio strategy. The limits for their use in any given year will be set out in the TMS and appendix B to the TMS.

- LOBOs (borrowing under lender's option/borrower's option) - Use of LOBOs will be considered as part of the annual borrowing strategy. Specific approval of the Director of Finance (Section 151 Officer) is required.

1.3.5 Policy concerning the use of derivatives for interest rate risk management

Currently, Local Authorities' legal power to use derivative instruments remains unclear. The General Power of Competence enshrined in the Localism Bill is not sufficiently explicit. Consequently, the authority does not intend to use derivatives.

Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require Full Council approval.

1.4 Exchange rate risk management

Exchange rate risk is the risk that unexpected changes in exchange rates expose the Council to greater costs or a shortfall in income than have been budgeted for. The Council has a minimal exposure to exchange rate risk as it has no powers to enter into loans or investments in foreign currency for treasury management purposes. It will also seek to minimise what risk it does have by using the policies below.

1.4.1 Approved criteria for managing changes in exchange rate levels

As a result of the nature of the Council's business, the Council may have an exposure to exchange rate risk from time to time. This will mainly arise from the receipt of income or the incurring of expenditure in a currency other than sterling.

SCC maintains a Euro account with its current bankers. This allows income to be received without incurring exchange costs for each transaction. A number of one-off, and recurring monthly payments are also made from the account. A relatively small balance is maintained, for which interest is received.

The Council will consider the use of a hedging strategy to control and add certainty to the sterling value of any transactions, if values are judged by the Director of Finance (Section 151 Officer) to be significant.

1.4.2 Policy concerning the use of derivatives for exchange rate risk management

Currently, Local Authorities' legal power to use derivative instruments remains unclear. The General Power of Competence enshrined in the Localism Bill is not sufficiently explicit. Consequently, the authority does not intend to use derivatives.

Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require full Council approval.

1.5 Inflation risk management

1.5.1 Investments over 1 year.

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.

1.6 Refinancing risk management

Refinancing risk is the risk that when loans or other forms of capital financing mature, that they cannot be refinanced where necessary on terms that reflect the assumptions made in formulating revenue and capital budgets. These budgets have therefore been set at a level after considering as many factors and rate forecasts as possible and this risk has thus been reduced to a level that is perceived as acceptable.

1.6.1 Debt/other capital financing, maturity profiling, policies and practices

The Council will establish through its Prudential Indicators the amount of debt maturing in any year/period.

Any debt rescheduling will be considered when the difference between the refinancing rate and the redemption rate is most advantageous and the situation will be continually monitored in order to take advantage of any perceived anomalies in the yield curve. The reasons for any rescheduling to take place will include:

- The generation of cash savings at minimum risk
- To reduce the average interest rate
- To amend the maturity profile and /or the balance of volatility of the debt portfolio.

1.6.2 Projected Capital Financing Requirement

The Director of Finance (Section 151 Officer) will prepare a three-year plan for capital expenditure for the Council. This is approved by members. The capital plan will be used to prepare a three-year revenue budget for all forms of financing charges.

Under the new capital financing system, the definition of capital expenditure and long-term liabilities used in the Code will follow recommended accounting practice.

1.6.3 Policy concerning limits on affordability and revenue consequences of Capital Financing

In considering the affordability of its capital plans, the Council will consider all the resources currently available/estimated for the future together with the totality of its capital plans, revenue income and revenue expenditure forecasts for the forthcoming year and the two following years and the impact these will have on Council tax. It will also take into account affordability in the longer term beyond this three-year period.

1.7 Legal and regulatory risk management

Legal and regulatory risk is the risk that either the Council, or a third party which it is dealing with in its treasury management activities, acts outside of its legal powers or regulatory requirements and as a result the Council incurs loss.

1.7.1 References to relevant Statutes and Regulations

The treasury management activities of the Council shall comply fully with legal statute, guidance, Codes of Practice and the regulations of the Council. The major relevant documents currently are:

- CIPFA's Treasury Management Code of Practice and accompanying Guidance Notes
- CIPFA Guide for Chief Financial Officers on Treasury Management in Local Authorities.
- CIPFA Prudential Code for Capital Finance in Local Authorities and subsequent amendments.
- CIPFA Standard of Professional Practice on Treasury Management
- The Local Government Act 2003
- The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 SI 2003 No 3146, and subsequent amendments
- The MHCLG's statutory Guidance on Minimum Revenue Provision (MRP)
- The MHCLG's Guidance on Local Government Investments in England The Local Authorities (Contracting out of Investment Functions) Order 1996 SI 1996 No 1883
- LAAP Bulletins
- Code of Practice on Local Authority Accounting
- Accounts and Audit Regulations 2003, as amended together with MHCLG's Guidance
- The Localism Act 2011
- The Bank of England's 2017 Money Markets Code (which replaces the former Non-Investment Products Code)
- Council's Constitution including:
  - Standing Order relating to Contracts
  - Financial Regulations
  - Scheme of Delegation

1.7.2 Procedures for evidencing the Council's powers/authority to counterparties

The Council's powers to borrow and invest are contained in legislation as follows:

Investing: Local Government Act 2003, section 12
Borrowing: Local Government Act 2003, section 1

SCC will bring this to the attention of interested counterparties as necessary.
Evidence of the SCC scheme of delegation, and the individual officers authorised to deal on behalf of the Council is sent to new counterparties.

1.7.3 Required information from counterparties concerning their powers / authorities

Lending will only be made to counterparties who fulfill the prevailing counterparty criteria.

When lending directly to a new counterparty, a list of permitted contacts is requested, along with Standard Settlement Instructions (SSIs) and bank details on headed paper.

When lending via a broker we rely on the broker to provide bank details and payment instructions.

1.7.4 Statement on the Council's political risks and management of same

The Director of Finance (Section 151 Officer) shall take appropriate action with the Council, the Chief Executive, and the Leader of the Council to respond to and manage appropriately political risks such as change of majority group, leadership in the Council, change of Government etc.

1.7.5 Responsibility for ensuring legality of Treasury Management function

The Monitoring Officer is the Strategic Manager - Governance and Risk. The duty of this officer is to ensure that the treasury management activities of the Council are lawful.

The Chief Financial Officer (Section 151 Officer) is the Director of Finance; the duty of this officer is to ensure that the financial affairs of the Council are conducted in a prudent manner and to make a report to the Council if he has concerns as to the financial prudence of its actions or its expected financial position.

1.8 Fraud, error and corruption, and contingency risk management

Fraud, error and corruption risk is the risk that the Council may fail to employ adequate systems, procedures and other arrangements that identify and prevent losses through such occurrences.

1.8.1 Fraud, Corruption, and Anti-Money Laundering Policies and Practices

The Council has a fraud and corruption, and an anti-money laundering policy in place. All members of the Investments team are familiar with the policies, which are posted on the SCC Internet site.

The Council is committed to the use of procedures and practices that will reduce the risk of the above, and will therefore: -

- Seek to ensure an adequate division of responsibilities and maintenance at all times of an adequate level of internal procedures that minimise such risks.
- Fully document all its treasury management activities so that there can be no possible confusion as to what proper procedures are.
- Staff will not be allowed to take up treasury management activities until they have had proper training in procedures and are then subject to an adequate and appropriate level of supervision.
- Records will be maintained of all treasury management transactions so that there is a full audit trail and evidence of the appropriate checks being carried out.

1.8.2 Details of systems and procedures to be followed, including internet services

Authority

1) The Scheme of Delegation to Officers sets out the delegation of duties to officers.
2) All loans and investments are negotiated by the Principal Investment Officer, or in his absence, the Funds and Investments Manager, the Senior Investment Officer or Deputy Senior Investment Officer (the dealer).
3) Cash movements and justification for Loan(s) are verified by one of a panel of checkers, with resulting CHAPS, BACS, International payments and Inter-Account Transfers being authorised by a designated senior finance officer, via Nat West proprietary on-line systems, using passwords and CHIP & PIN technology.

Procedures

A fully documented procedures guide is kept for reference. This provides a very brief and simplified outline of the key stages for daily Treasury Management.

1) Overall daily balances are determined from downloaded bank information. ENPA and SWRB balances are separately identified and transfers to or from the main SCC bank account are affected to bring balances back to zero.
2) Payments or receipts of loans or loan interest are identified via the Treasury Management database.
3) Other payments / receipts are identified from the cash flow element of the TM database and other sources.
4) Excess cash will be invested according to security of investment, liquidity needs and prevailing market rates. Shortfalls will be covered by money in call accounts or short-term borrowing.

Investment and borrowing transactions

1) A detailed register of all loans and investments is maintained in the TM database. This is updated immediately after loans have been agreed. Accuracy of this is verified by the daily checking process.
2) Written confirmation is received and checked against the dealer's records for the transaction. Any discrepancies are immediately reported to the dealer for resolution. This acts as a second verification for accuracy of the database.
3) A broker note showing details of the loan arranged confirms all transactions placed through brokers. Any discrepancies are immediately reported to the broker, for resolution.

Regularity and security

1) Lending is only made to institutions that fulfill the relevant counterparty criteria.
2) The TM database prompts the dealer that money borrowed or lent is due to be repaid.
3) All loans raised and repayments made go directly to and from the bank account of approved counterparties.
4) Counterparty limits are set for every institution that the Council invests with.
5) Brokers have a list of SCC counterparty criteria and named officials authorised to agree deals.
6) Counterparties with whom SCC deals directly have a list of officials authorised to agree deals.

7) There is a separation of duties in the section between dealers and the checking and authorisation of all deals.
8) No member of the treasury management team is an authorised signatory for payments made from any SCC account.
9) Payments are verified by one of a panel of checkers. Payments entered onto the Nat West proprietary system can only be authorised by nominated senior officers.
10) The Nat West Bankline system can only be accessed by password, and authorisation can only be achieved by using CHIP & PIN technology.

Checks

1) One of a panel of checkers verifies that all daily cash movements are accurate, complete, and duly authorised.
2) Entries to the loans database are checked for accuracy and completeness. Reports are presented showing loans outstanding and current balances with counterparties, highlighting the loans made that day, and their effect on balances held with counterparties.
3) Where investments are made, current ratings of counterparties are attached to loan documentation, giving the checker and ultimately the authoriser, opportunity to verify the counterparty creditworthiness.
4) Entries onto the Nat West system are checked for accuracy and completeness, giving an opportunity for challenge of details.
5) Bank reports are monitored and retained, showing the progressive status of payments. Any variances are immediately investigated and resolved.
6) A reconciliation of payments and receipts is carried out daily from the bank statement to the TM database, and periodically to the financial ledger.
7) Interest, both paid and received is periodically reconciled to bank statements and the financial ledger.

Calculations

1) The calculation of repayment of principal and interest notified by the lender or borrower is checked for accuracy against the amount calculated by the TM database.

Use of Internet Services

1) The Internet is used for a variety of functions performed during the course of treasury management. The application and the security of SCC instructions and data are paramount. To this effect, all proposed new systems are discussed and risk-assessed in conjunction with the Internal Audit team at SCC, prior to their use.

1.8.3 Emergency and Contingency Planning arrangements

Disaster Recovery Arrangements

All computer files are backed up on the dedicated Investments team server. All systems input is filed separately until a backup of data is taken each night. Having a dedicated server enables files to be accessed from remote sites.

In the event of massive systems failure, SCC personnel can work offsite via VPN.

1.8.4 Insurance cover details

The Council has 'Fidelity' insurance cover. This covers the loss of cash by fraud or dishonesty of employees.

The Council also has a 'Professional Indemnity' insurance policy, which covers loss to third parties from the actions and advice of its Officers, which are negligent and without due care. This cover is limited to £10m for any one event with an excess of £100,000
The Council also has a 'Business Interruption' cover as part of its property insurance.

1.9 Market value of investments risk management

Market risk is the risk that, through adverse market fluctuations in the value of the principal sums the Council borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately.

1.9.1 Details of approved procedures and limits for controlling exposure to investments whose capital value may fluctuate (Gilts, CDS, etc.)

Gilts, Commercial Paper, CD's and Money Market Funds (MMFs) are among the products that SCC may use, that pose market risk.

The Council may consider an investment in Pooled Funds with a Variable Net Asset Value (VNAV), as appropriate, in line with its treasury strategy and on advice from its treasury advisors. The value of the pooled funds will change in line with market prices and, in some instances, may also have a notice period prior to redemption. Such funds will therefore be used for longer investment periods. The limits per fund/asset class will be as determined in the Council's annual investment strategy.

2.1.1 Policy concerning methods for testing value for money

Best value reviews will include reviews of the way services are provided by

- Challenging
- Comparing performance
- Consulting with other users and interested parties
- Applying competition principles

In order to pursue continuous improvement in the way the Council's functions are exercised, having regard to a combination of value for money, efficiency and effectiveness.

2.1.2 Policy concerning methods for performance measurement

Performance measurement at the Council is intended to calculate the effectiveness of treasury activity in delivering the strategic objectives set through the Treasury Management Strategy and the Council's Prudential Indicators and to enhance accountability

Prudential Indicators are specific to the Council and not intended as a comparator between authorities

The performance review will be made in the light of general trends in interest rates during the year and how the decisions made corresponded with these trends and the Council's agreed strategy (i.e. the Council will avoid hindsight analysis)

Any comparison of the Council's treasury portfolio against recognised industry standards, market indices and other portfolios is intended to:

Allow the Council the opportunity to assess the potential to add value through changes to the existing ways in which its portfolio is managed, and permit an informed judgement about the merits or otherwise of using new treasury management techniques or instruments.

In drawing any conclusions, the Council will bear in mind that the characteristics of its treasury operations may differ from those of other councils, particularly with regard to the position on risk.

2.1.3 Periodic reviews during the financial year

The Director of Finance (Section 151 Officer) and Strategic Manager – Finance Technical hold a treasury management review meeting with senior members of the investments team on a monthly basis, to review actual activity against the Treasury Management Strategy and cash flow forecasts. This will include: -

- Evaluation of borrowing activity during the period under review
- Total debt including average rate and maturity profile
- Total investments including average rate and maturity profile
- Changes to the above from the previous review and against the TMS
- Counterparty exposure
- Exposures relative to Prudential Indicators
- Future interest rates and strategy are discussed

2.1.4 Mid-year review

A Mid-year Review is submitted to Full Council, which reviews all activities involving the treasury management operation for the first six months of the year. This report contains the following: -

- Total debt and investments at the beginning of the year and at mid-year
- Borrowing activity for the 6-month period compared to strategy
- Investment activity for the 6-month period compared to strategy
- Explanations for variance between original strategies and activities
- Debt rescheduling undertaken in the period
- Actual borrowing and investment rates available through the period
- Comparison of return on investments to the investment benchmark
- Compliance with Prudential Indicators
- Other

2.1.5 Annual Review after the end of the financial year

An Annual Treasury Outturn Report is submitted to Full Council each year after the close of the financial year, which reviews all activities involving the treasury management operation. This report contains the following: -

- Total debt and investments at the beginning and close of the financial year and average interest rates
- Borrowing activity for the year compared to strategy
- Investment activity for the year compared to strategy
- Explanations for variance between original strategies and activities
- Debt rescheduling done in the year
- Actual borrowing and investment rates available through the year
- Comparison of return on investments to the investment benchmark
- Compliance with Prudential Indicators
- Other

2.1.6 Comparative reviews

When data becomes available, comparative reviews are undertaken to see how the performance of the authority on debt and investments compares to other authorities with similar size portfolios (but allowing for the fact that Prudential Indicators are locally set). Data used can be sourced from: -

- CIPFA Treasury Management statistics published each year for the last complete financial year
- Treasury Advisors

When comparing outcomes, it is most important to find out why any variance from other Local Authorities is occurring, and to understand the relative risks of the portfolios. In drawing any conclusions, the Council will consider that the risk characteristics of other treasury management operations may differ from those of the Council's. Factors to consider are: -

- Use of different counterparties, by type and name
- Differing views on, and suitability of duration, at a portfolio and counterparty level

- Levels of cash to be invested
- Different advice of Treasury Advisors
- Availability and suitability of various instruments

2.2 Benchmarks and calculation methodology with regard to risk and return

2.2.1 Debt management

The overriding objective for approved borrowing is that it will be carried out in line with the CIPFA TM Code, i.e. that performance measurement should consider risk as well as return (borrowing rate). Priority will be given to risk management, and then the pursuit of minimising rate. There are many circumstances that may force borrowing at rates higher than the lowest achievable rate but may be directly attributable to good risk management or differing risk tolerances. These may include: -

- Taking loans of a stated maturity regardless of rate to ensure the desired maturity profile and thereby reduce refinancing risk.
- Taking Lender's Options Borrower's Option (LOBO) loans with greater regard to the structure rather than the cheapest rate where optionality exposes the Authority to refinancing, liquidity, and interest rate risk.
- Taking LOBO loans that dovetail with existing LOBO optionality.
- It may not be policy to borrow in advance of need even though it may be generally accepted that rates will go higher in the near future.
- It may be prudent to wait until capital expenditure has been incurred before loans are taken, even though rates may increase in the interim.

There are simple performance benchmarking measures available, i.e. debt rate achieved in relation to average PWLB rates for the year, for any given maturity and type of loan. However, it is suggested that each loan be looked at individually to develop an appreciation of the factors influencing performance, with a view to improving the future processes of treasury decision-making.

CIPFA produces detailed reports of our performance compared with other authorities. Whilst these headline figures can be a useful guide in assessing performance, they should not be seen in isolation. It is important to also assess performance against the stated objectives and specific needs of SCC during the year, and to take a wider view in relation to timeframes and overall risk management. There are many factors that affect treasury performance that are not apparent from the CIPFA reports.

It will be highlighted that each authority will have different needs during any given year. For example, a large capital requirement in a year when borrowing rates are high can have an enormous adverse effect on the overall portfolio performance for years to come. Conversely, a high rate loan that drops out of a small portfolio can make performance look extremely impressive in a year when no activity was undertaken.

The CIPFA reports look at one year in isolation. LOBOs can be taken and reported with a reduced rate initially, but with a big increase after an initial period that is not apparent in the reporting period.

The above caveats aside, these reports can offer insight into specific areas of debt and can be used to challenge and inform prevailing strategy and tactics.

2.2.2 Investment

The overriding aim of SCC is in line with CLG guidance, i.e. to invest prudently. The guidance defines a prudent investment policy as having two objectives: achieving first of all security (protecting the capital sum from loss) and then liquidity (keeping the money readily available for expenditure when needed). It goes on… "Provided that proper levels of security and liquidity are achieved, it may then (but only then) be reasonable to seek the highest yield consistent with those priorities".

Similar to the debt portfolio, these headline figures can be a useful guide in assessing performance but should not be seen in isolation. It is important to take a wider view in relation to timeframes and overall risk management.

There may be different priorities to satisfy revenue or capital requirements. If revenue interest is the priority in a low interest rate environment, the need for extra yield may influence investment decisions.

Overall policy and risk appetite will differ, as will the techniques and tools used to achieve objectives, and as part of risk management.

2.3 Policy concerning best value in Treasury Management

2.3.1 Banking services

The Council's current banking arrangements are for a five-year contract starting in April 2015. Pricing is to be reviewed every three years, to ensure that tariffs, and volume of transactions used for tariffs continue to be value for money and appropriate respectively.

2.3.2 Money-broking services

In addition to direct dealing with counterparts, use is made of money broking services in order to make deposits or to borrow and will establish charges for all services prior to using them.

An approved list of brokers will be established which takes account of both prices (if borrowing is required) and quality of services.

2.3.3 Consultants'/advisers' services

Arlingclose Ltd, have been treasury advisors to SCC since 2009. They provide ongoing independent analysis and advice on market and investment conditions, and the suitability of counterparties among other services. The full schedule of services they provide can be found at 11.1.3.

SCC recognises, as per CIPFA guidance, that, "the overall responsibility for treasury management must always remain with the Council". SCC has always performed its own analysis of market and investment conditions, and the suitability of counterparties. It continues to do so through embedded practices, thereby maintaining the skills of the in-house team. This ensures that services provided by advisors can be challenged, and that undue reliance is not placed on them.

2.3.4 Policy on External Managers (Other than relating to Pension Fund)

The delegation of investment management, if appointed, to external managers will entail the following: -

- Formal contractual documentation;
- Agreement on terms for early termination of the contract;
- Setting of investment instruments, constraints/parameters/conditions
- Setting of investment counterparty limits;
- Setting a performance measurement benchmark and a performance target;
- Frequency of performance reporting;
- Frequency of meetings with investment managers;

The activities of any appointed external manager will be regularly reviewed by the Director of Finance (Section 151 Officer) and reported appropriately.

3.1 Funding, borrowing, lending, and new instruments / techniques

3.1.1 Records to be kept

The Treasury section has a dedicated database system (Logotech), in which all investment and loan transactions are recorded. The following records will be retained: -

- Daily cash balance forecasts
- Rates available on the day, from two brokers (to support investment decision)
- Copy of dealing sheet highlighting rates quoted from direct counterparties, and that sufficient headroom is available for proposed investment
- Confirmation of counterparty ratings
- Deal ticket for all money market transactions
- List of outstanding investments and counterparty limits
- Brokers' confirmations for investment and temporary borrowing transactions
- Confirmations from borrowing / lending institutions
- Other documentation as required to support the decision, i.e. PWLB rates if LOBO taken.

3.1.2 Processes to be pursued

- Ongoing review of economic factors, and analysis of their impact re opportunities and threats to the debt and investment portfolios
- Cash flow forecasting and analysis
- Debt and investment maturity analysis
- Review of opportunities for debt restructuring
- Review of borrowing requirement to finance capital expenditure
- Performance information (e.g. monitoring of actual against budget for debt charges and interest earned).

3.1.3 Issues to be addressed

3.1.3.1 In respect of every treasury management decision made the Council will: -

- Above all be clear about the nature and extent of the risks to which the Council may become exposed
- Be certain about the legality of the decision reached and the nature of the transaction, and that all authorities to proceed have been obtained
- Be content that the documentation is adequate both to deliver the Council's objectives and protect the Council's interests, and to deliver good housekeeping
- Ensure that third parties are judged satisfactory in the context of the Council's creditworthiness policies, and that limits have not been exceeded
- Be content that the terms of any transactions have been fully checked against the market, and have been found to be competitive

3.1.3.2 In respect of borrowing and other funding decisions, the Council will: -

- Evaluate economic and market factors to form a view on future interest rates so as to determine the manner and timing of decisions to borrow
- Consider the sources of borrowing, alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use
- Consider the merits and demerits of alternative forms of funding, including funding from revenue, leasing and private partnerships to minimise costs and risks
- Consider the ongoing revenue liabilities created, and the implications for the Council's future plans and budgets
- Seek to reduce the overall level of financing costs / smooth maturity profiles through debt restructuring

3.1.3.3 In respect of investment decisions, the Council will: -

- Consider the optimum period, in the light of cash flow availability and prevailing market conditions
- Consider the alternative investment products and techniques available, especially the implications of using any which may expose the Council to changes in the value of its capital
- Determine appropriate credit policy limits and criteria to minimise the Council's exposure to credit and other investment risks

TMP 4 APPROVED INSTRUMENTS, METHODS AND TECHNIQUES

4.1 Approved activities of the Treasury Management operation

- Borrowing
- Lending
- Debt repayment and rescheduling
- Consideration, approval and use of new financial instruments and treasury management techniques
- Managing the underlying risk associated with the Council's capital financing and surplus funds activities
- Managing cash flow
- Banking activities
- Leasing

4.2 Approved instruments for investments

As investment instruments are constantly being developed and evolved by financial institutions, staff will keep abreast of developments and report to the monthly TM meeting, those that it feels may be considered for use by SCC. The Director of Finance (Section 151 Officer) has the delegated authority to approve the use of any such investments, subject to what has been approved by members in the TMS, and prudential limits.

Those currently used, or that are proposed to be used in the next year, will be detailed in the TMS approved by Full Council each year.

4.3 Approved techniques

- Forward dealing
- The use of Snowballs, Range Trades, Escalators, Callable deposits, or any other structured investment approved by the Director of Finance (Section 151 Officer)
- LOBOs - lenders' option, borrowers' option borrowing instrument

4.4 Approved methods and sources of raising capital finance

Finance will only be raised in accordance with the Local Government Act 2003 and within this limit the Council has a number of approved methods and sources of raising capital finance. These are: -

- Public Works Loans Board (PWLB) loans and any successor body
- long term money market loans including forward starting loans and LOBOs
- temporary money market loans (up to 364 days)
- bank overdraft
- loans from bodies such as the European Investment Bank (EIB)
- Stock issues

- Deferred Purchase
- Government and EU Capital Grants
- Lottery monies
- Other Capital Grants and Contributions
- Private Finance Initiative
- Operating and finance leases
- Hire purchase
- Sale and leaseback

The Council may also use internal resources:

- Capital Receipts
- Revenue Balances
- Reserves

Borrowing will only be done in Sterling. All forms of funding will be considered dependent on the prevailing economic climate, regulations and local considerations. The Director of Finance (Section 151 Officer) has authority to take the most appropriate form of borrowing from the approved sources.

4.5 Investment limits

The TMS sets out the limits and the guidelines for use of each type of investment instrument.

4.6 Borrowing limits

See the TMS and Prudential Indicators for agreed annual limits.

4.7 Issues to be addressed when considering treasury activities

In exercising treasury activities, officers will

- have regard to the nature and extent of any associated risks to which the Council may become exposed and put in place effective mechanisms for risk management and mitigation
- be certain about the legality of the decision reached and that the necessary authority to proceed has been obtained
- be satisfied that the documentation is appropriate to deliver the Council's objectives, protect the Council's interests, and to maintain an effective audit trail

- ensure that the perceived credit risk associated with the approved counterparties parties is judged satisfactory and is within agreed limits

- be satisfied that the terms of any transactions have been fully checked against the market, and have been found to be competitive

- follow best practice in implementing the treasury transaction

In exercising borrowing and funding decisions, officers will:

- evaluate economic and market factors that may influence the manner and timing of any decision to fund

- consider alternative forms of funding, including use of revenue resources, leasing and private partnerships

- consider the use of internal resources and/or the most appropriate periods to fund and repayment profiles to use

- consider ongoing revenue liabilities created

- where applicable, monitor regularly the benefits of internal borrowing against the potential for incurring additional costs by deferring borrowing into future years

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.

In exercising Investment decisions, officers will:

- Determine that the investment is within the Council's strategy and pre-determined instruments and criteria;

- consider the optimum period, in the light of core balances and reserves, cash flow availability and prevailing market conditions;

- the credit risk associated with unsecured investments with banks and building societies

- consider the alternative investment products and techniques available if appropriate.

4.8 Use of Derivatives

The revised CIPFA TM code requires that the Council must explicitly state whether it plans to use derivative instruments to manage risks.

Currently, Local Authorities' legal power to use derivative instruments remains unclear. The General Power of Competence enshrined in the Localism Bill is not sufficiently explicit. Consequently, the authority does not intend to use derivatives.

Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require Full Council approval.

In developing a risk management framework governing the use of derivatives, SCC Officers would need to: -

- Ensure full understanding of the product(s)
- Demonstrate the derivative transaction has reduced overall exposure to treasury risks
- Consider whether officers have the skills and experience to identify, evaluate and control the risks involved.

TMP 5 ORGANISATION, CLARITY AND SEGREGATION OF RESPONSIBILITIES, AND DEALING ARRANGEMENTS — SCHEDULE E

5.1 Limits to responsibilities / discretion at Council / Executive levels

- ✓ Full Council will approve the Prudential Indicators and revise them as and when necessary
- ✓ Full Council will receive and review reports on treasury management policies, strategies, and activities.
- ✓ The Director of Finance (Section 151 Officer) will be responsible for amendments to the Council's adopted clauses, treasury management policy statement and treasury management practices.
- ✓ The Director of Finance (Section 151 Officer) will approve the segregation of responsibilities
- ✓ The Director of Finance (Section 151 Officer) or Strategic Manager – Finance Technical will receive and review internal and external audit reports and put recommendations to the Audit Committee
- ✓ Approving the selection of external service providers and agreeing terms of appointment will be decided by the Director of Finance (Section 151 Officer)

5.1.1 Principles and practices concerning segregation of duties

Separate officers must undertake the following duties: -

Dealing	Negotiation and approval of deal – Dealer
	Receipt and checking of brokers confirmation note against loans diary – Finance Assistant
	Reconciliation of cash control account – Corporate Accounting Team (CATS)
	Bank reconciliation – CATS (2)
Checking	Verification of accuracy of information and legitimacy of payments - Panel of approved senior officers
Payment of Deal	Entry onto system - Dealer
	Approval and payment – Approved authorisers
Accounting Entry	Production of transfer note – Dealer
	Processing of accounting entry – Cashiers / CATS

5.1.2 Treasury Management organisation chart

Director of Finance (Section 151 Officer)
↓
Strategic Manager - Pension Fund and Service Management.
↓
Investments Manager
↓
Principal / Senior Investment Officer
↓
Finance Assistant

5.2 Statement of duties / responsibilities of each treasury post

5.2.1 The Director of Finance (Section 151 Officer)

The Director of Finance (Section 151 Officer) will: -

- Submit budgets and budget variations in accordance with Financial Regulations and guidance.
- In setting the prudential indicators, the Director of Finance (Section 151 Officer) will be responsible for ensuring that all matters are taken into account and reported to the Cabinet so as to ensure the Council's financial plans are affordable, prudent and sustainable in the long term.
- Establish a measurement and reporting process that highlights significant variations from expectations.
- Make reports to the Cabinet under S114 of the Local Government Finance Act 1988 if the Director of Finance (Section 151 Officer) considers the Council is likely to get into a financially unviable situation.
- Recommend treasury management policy, strategy, and practices for approval, reviewing the same on a regular basis, and monitoring compliance.
- Submit treasury management reports as required to the Full Council.
- Review the performance of the treasury management function and promote best value reviews.
- Ensure the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function.
- Ensure the adequacy of internal audit and liaise with external audit.
- Recommend on appointment of external service providers in accordance with Council standing orders.

2) The Director of Finance (Section 151 Officer) has delegated powers through this policy to take the most appropriate form of borrowing from the approved sources, and to make the most appropriate form of investments in approved instruments.

3) The Director of Finance (Section 151 Officer) may delegate his power to borrow and invest to members of his staff. The Treasury Management Team must conduct all dealing transactions, or staff authorised by the Director of Finance (Section 151 Officer) to act as temporary cover for leave/sickness.

4) The Director of Finance (Section 151 Officer) will ensure that Treasury Management Policy is adhered to, and if not will bring the matter to the attention of elected members as soon as possible.

5) Prior to entering into any capital financing, lending or investment transaction, it is the responsibility of the Director of Finance (Section 151 Officer) to be satisfied, by reference to the County Solicitor and external advisors as appropriate, that the proposed transaction does not breach any statute, external regulation or the Council's Financial Regulations.

6) It is also the responsibility of the Director of Finance (Section 151 Officer) to ensure that the Council complies with the requirements of The Bank of England's 2017 Money Markets Code for principals and broking firms in the wholesale markets.

The Director of Finance (Section 151 Officer) may delegate some or all of the above duties that do not fall under the responsibility of the Section 151 Officer, to the Deputy Section 151 Officer.

5.2.2 The Investments Team will be responsible for: -

1) Execution of transactions and conduct of other day-to-day activities in accordance with the Treasury Management Practices.

2) Adherence to agreed policies and limits.

3) Managing the overall treasury management function.

4) Ensuring appropriate segregation of duties.

5) Monitoring performance on a day-to-day basis.

6) Submitting management information reports to the Director of Finance (Section 151 Officer).

7) Maintaining relationships with third parties and external service providers and reviewing their performance.

5.2.3 The Monitoring Officer – The Strategic Manager – Governance & Risk

The responsibilities of this post will be: -

1) Ensuring compliance by the Director of Finance (Section 151 Officer) with the treasury management policy statement and treasury management practices, and that they comply with the law.

2) Being satisfied that any proposal to vary treasury policy or practice complies with law or any code of practice.

3) Giving advice to the Director of Finance (Section 151 Officer) when advice is sought.

5.2.4 Internal Audit

The responsibilities of Internal Audit will be: -

1) Reviewing compliance with approved policy and treasury management practices.

2) Reviewing division of duties and operational practice.

3) Assessing value for money from treasury activities.

4) Undertaking probity audit of treasury function.

In all cases, audits will be conducted using a risk-based approach, identifying, assessing, and recommending mitigation actions relating to treasury management risks.

5.3 Absence cover arrangements

In the absence of the Principal Investment Officer, the responsibility for day-to-day operations of the Treasury Management function rests with the Investments Manager, or the Senior Investment Officer and Deputy.

5.4 Dealing limits

To ensure flexibility and maximum continuity, there are no dealing limits for individual posts

5.5 List of approved brokers

A list of approved brokers is maintained within the Treasury Management Team and a record of all transactions recorded against them. See TMP 11.1.2.

5.6 Policy on brokers' services

It is the Council's policy to allocate business between brokers on an equitable basis whenever possible. However, for similar levels of counterparty risk and liquidity, the broker with the most advantageous rate will be used.

5.7 Policy on taping of conversations

It is the Council's policy not to tape conversations with counterparties or brokers.

5.8 Direct dealing practices

The Treasury Management team deal directly with counterparties in addition to the use of money brokers. A copy of the counterparty Standard Settlement Instructions (SSIs) is required before funds are placed.

5.9 Settlement transmission procedures

All settlements are dealt through the Clearing Houses Automated Payments System (CHAPS) via the SCC bankers' proprietary system. After checking for accuracy and authenticity of counterparty bank details by the checker, one of a pool of authorised signatories sends the payment raised by the Dealer.

5.10 Documentation requirements

For each deal undertaken a record is entered into the TM database, giving details of dealer, amount, period, counterparty, interest rate, dealing date, payment date(s), and broker. A print of each deal is attached to the pack of papers along with a revised balances outstanding report and a revised counterparty limits report. Prints of the proposed counterparty rating(s) are also attached. These documents are verified before payments are sent.

Any breach of counterparty limit is referred to the Director of Finance (Section 151 Officer) or other senior officer, who has the discretion to authorise the breach, dependent on circumstances.

5.11 Arrangements concerning the management of counterparty funds

SCC has a contract to provide treasury management services to the Police and Crime Commissioner for Avon and Somerset. It manages these funds on a segregated basis under contractual arrangements.

SCC manages funds on behalf of Exmoor National Park Authority, and the South West Regional Board. This money is managed on an aggregated funds basis under terms agreed in a Service Level Agreement.

SCC manages funds of other public or not-for-profit organisations via the Comfund. Specified terms and conditions are agreed and signed by participating bodies.

TMP 6 REPORTING REQUIREMENTS AND MANAGEMENT INFORMATION ARRANGMENTS

6.1 Annual Treasury Management Strategy

The TMS sets out the specific expected treasury activities for the forthcoming financial year. This strategy will be submitted to Full Council for approval before the commencement of each financial year. It will also be made available to the Audit Committee.

The formulation of the annual TMS involves determining the appropriate borrowing and investment decisions in the light of the anticipated movement in both fixed and shorter-term variable interest rates. For instance, the Council may decide to postpone borrowing if fixed interest rates are expected to fall or borrow early if fixed interest rates are expected to rise.

The TMS is concerned with the following elements: -

- Current Treasury portfolio position
- Borrowing requirement
- Borrowing strategy
- Debt rescheduling
- Investment strategy
- Prudential Indicators
- Any extraordinary treasury issue

The TMS will take into account expected moves in interest rates against alternatives (using all available information such as published interest rate forecasts where applicable) and consider sensitivities in different scenarios.

6.2 Prudential Indicators

The Council approves before the beginning of each financial year a number of treasury limits which are set through Prudential Indicators.

The Director of Finance (Section 151 Officer) is responsible for incorporating these limits into the annual TMS, and for ensuring compliance with the limits. Should it prove necessary to amend these limits, the Director of Finance (Section 151 Officer) shall submit the changes for approval to the Council.

6.3 Mid-year review of activity

A mid-year report will be presented to Full Council at the earliest practicable meeting after the end of the first half of the financial year. This report will include the following: -

- ✓ Movement in the debt and investment portfolios during the first six months
- ✓ Significant transactions executed
- ✓ Measurements of performance
- ✓ Monitoring of compliance with approved policy, prudential limits, practices and statutory / regulatory requirements, and reporting of any deviations
- ✓ Risk management

6.4 Annual report on Treasury Management activity

An annual report will be presented to Full Council at the earliest practicable meeting after the end of the financial year. This report will include the following: -

- ✓ A comprehensive picture for the financial year of all treasury policies, strategies, activities and results
- ✓ Movement in the debt and investment portfolios during the year
- ✓ Significant transactions executed
- ✓ Measurements of performance
- ✓ Monitoring of compliance with approved policy, prudential limits, practices and statutory / regulatory requirements, and reporting of any deviations
- ✓ Risk management

6.5 Management information reports

Management information reports will be prepared at regular intervals by the Treasury Management Team and will be presented to the Director of Finance (Section 151 Officer) at monthly meetings. The reports are used to inform discussion on current, future, and potential risks, past performance and future tactics and operations. They focus on the risks to the achievement of TM objectives, and the tools, techniques, and tactics to mitigate risks.

Management reports will contain the following information: -

1) Movements in interest and money market rates and the yield curve
2) Movements in SCC cash, cash balances, and types of deposit made
3) Performance of investments
4) Comfund performance and details of investments made
5) Current debt portfolios, including analysis of market loans
6) Movements in PWLB and market rates and opportunities / threats arising
7) Current and changes (actual and potential) to ratings of current and potential counterparties
8) Analysis of risk metrics for investment portfolios
9) Compliance with Prudential limits and other stated policies, strategies, codes of practice, and practices
10) Any other treasury management business

TMP 7 BUDGETING, ACCOUNTING AND AUDIT ARRANGEMENTS

7.1 Statutory / Regulatory requirements

The accounts are drawn up in accordance with the Code of Practice on Local Authority Accounting in Great Britain that is recognised by statute as representing proper accounting practices. The Council has also adopted in full the principles set out in CIPFA's 'Treasury Management in the Public Services - Code of Practice' (the 'CIPFA Code'), together with those of its specific recommendations that are relevant to the Council's treasury management activities.

7.2 Accounting Practices Standards

Due regard is given to the CIPFA Code of Practice on Local Authority Accounting Practices.

7.3 Sample budgets / accounts / Prudential Indicators

The Director of Finance (Section 151 Officer) will prepare a three-year medium-term financial plan with Prudential Indicators for treasury management, which will incorporate the budget for the forthcoming year and provisional estimates for the following two years. This will bring together all the costs involved in running the function, together with associated income. The Director of Finance (Section 151 Officer) will exercise effective controls over this budget and monitoring of performance against Prudential Indicators, and will report upon and recommend any changes required in accordance with TMP6.

7.4 List of information requirements of external auditors

- Reconciliation of loans outstanding in the financial ledger to Treasury Management records
- Maturity analysis of loans outstanding
- Certificates for new long-term loans taken out in the year
- Reconciliation of loan interest, discounts received, and premiums paid to financial ledger by loan type
- Calculation of loans fund interest and debt management expenses
- Details of interest rates applied to internal investments
- Calculation of interest on working balances
- Interest accrual calculation
- Principal and interest charges reports from the Treasury Management system
- Analysis of any deferred charges
- Calculation of loans fund creditors and debtors
- Mid-year and Annual Treasury Outturn Reports
- Treasury Management Strategy and Prudential Indicators
- Information of charges to the Income & Expenditure account in respect of MRP analysed into its constituent parts
- Details of any amounts held on behalf of external bodies and movements in those funds during the year.

8.1 Arrangements for preparing cash flow statements

Cash flow projections are prepared regularly. The annual and monthly cash flow projections are prepared from the previous years' cash flow records, adjusted for known changes in levels of income and expenditure and also changes in payments and receipts dates. These details are supplemented on an ongoing basis by information received of new or revised amounts to be paid or received as and when they are known.

Cash flow is recorded on the TM database with as great an accuracy as is possible, to assist in analysis and better future predictions.

All efforts are made to contact various departments prior to the financial year in order to ascertain timings and amounts of grants and other income to be received, or payments to be made.

Cash flow forecasts are updated daily as information flows from payroll, creditors etc. pass through the TM team for payment.

8.2 Bank statements procedures

The Corporate Accounting Team receives daily bank statements and a daily download of data from the bank. All amounts on the statement are checked to source data from Treasury Management documents as well as Payroll and Creditor information. The Corporate Accounting Team (CATS) allocates expenditure to codes daily, which helps to identify differences. Cashiers perform the same process for income. CATS also undertake formal bank reconciliation on a monthly basis.

8.3 Payment scheduling and agreed terms of trade with creditors

SCC policy is to pay creditors at the latest possible date within the terms of the creditor. The creditor system is able to apply different terms for each creditor. The Exchequer Team performs this function. The Exchequer team is also responsible for the arrangements for monitoring debtor and creditor levels.

There may be occasions where advantageous terms can be gained by paying in advance of contractual terms. The decision to enter into revised terms will remain with the senior officers responsible for the budget.

8.4 Procedures for banking of funds

All money received by an officer on behalf of the Council will without unreasonable delay be passed to the bankers to deposit in the Council's banking accounts.

9.1 Procedures for establishing identity / authenticity of lenders

The Council does not accept loans from individuals.

All loans are obtained from the PWLB, other local authorities or from authorised institutions under the Financial Services and Markets Act 2000. This register can be accessed through the Financial Conduct Authority (FCA) website at www.fca.org.uk

When repaying loans, the procedures in 9.2 will be followed to check the bank details of the recipient.

9.2 Methodology for identifying deposit takers

In the course of its Treasury activities, the Council will only lend money to or invest with those counterparties that fulfill the counterparty criteria approved by Full Council, as part of the Annual Treasury Strategy. Where these are deposits, they will only be placed with a Financial Institution that is authorised by the Prudential Regulation Authority to accept deposits, is a Building Society incorporated in the UK, or is a passported EEA institution. A 'List of Banks' is published by the Prudential Regulation Authority (PRA) and can be accessed through the Bank of England website http://www.bankofengland.co.uk/pra/Pages/authorisations/banksbuildingsocietieslist.aspx The exceptions to this are other Local Authorities and the DMO.

Where a counterparty is contracted via a broker, the broker confirms bank details. Where SCC has previously used the counterparty, details are checked against those currently held. Any changes are confirmed by the broker and by the counterparty on headed paper. When a broker introduces a new counterparty, SSIs on headed paper are requested.

When dealing with counterparties direct, a copy of SSIs is requested, as well as a list of contacts that are authorised to transact and / or provide information.

All payment transactions are carried out via CHAPS, for making deposits or repaying loans.

9.3 Proceeds of Crime Act 2002 (POCA)

Please find below an explanation of the current responsibilities of local authorities: -

> *The Proceeds of Crime Act 2002 imposes an obligation on any person or other body that undertakes a regulated activity as defined by the Act to report any incident that leads them to suspect that an individual or other body is making transactions with the proceeds of any criminal activity. This is an extension of the obligations previously imposed principally on financial services organisations and employees under money laundering legislation. The money laundering legislation, as reinforced by the FSA guidance, made it clear that an organisation had to nominate a money laundering reporting officer, MLRO, through whom suspicious transactions had to be reported and it was incumbent on the MLRO to decide if these transactions had to be reported to the National Criminal Investigation Service (NCIS), being the police body charged with dealing with these matters.*

The question therefore arises as to whether organisations now caught under the provisions of the Proceeds of Crime Act (POCA) have to also nominate a MLRO. There is nothing that states that an MLRO has to be nominated and indeed, a number of organisations that are caught by POCA would not have a direct regulator to notify. However, it is equally clear that such organisations must have a process in place whereby employees can alert management of activities that may fall under POCA and that process must make it clear to whom an internal report has to be made. Therefore, whether called an MLRO or not, under their internal processes organisations need to appoint a senior officer (F.D., Treasurer, Head of Legal) to whom suspicions must be reported and who is responsible for deciding whether to pass the report to NCIS.
NCIS
PO BOX 8000
LONDON SE11 5EN

www.ncis.co.uk

The Director of Finance (Section 151 Officer) is conversant with the requirements of the Proceeds of Crime Act 2002 and will train the following staff in being diligent to be alert for suspicious transactions: -

- Treasury management
- Cashiers section
- Other as appropriate

The Council has appointed the Funds and Investments Manager to be the responsible officer to whom any suspicions that transactions involving the Council may include a party who is involved in criminal activity. Suspicious transactions will be investigated as far as the Council is in a position to do so or it is appropriate for the Council to do so, and if doubts remain, these transactions will then be reported to the National Criminal Investigation Service.

9.4 Other relevant Legislation

Money Laundering Regulations 2007 - SCC has written Anti Money Laundering, and Anti-Fraud and Corruption Policies, which are available on the intranet. The Investments Team is aware of these policies.

Terrorism Act 2000 – Local Authorities are subject to full provisions

Bribery Act 2010 – Local Authorities should be mindful of its requirements

10.1 Details of approved training courses

SCC does not currently subscribe to membership of the CIPFA Treasury Management Network but attends seminars on an ad hoc basis. to keep abreast of relevant industry and market developments, and to share best practice with practitioners from other Local Authorities and Public Services.

There is no list of approved training courses maintained, but sources of training and contents of courses and seminars are received frequently from a host of external suppliers. In line with the Council Line Management & Annual Review (LMAR), courses deemed suitable will be suggested and approved accordingly. These may be provided by CIPFA, ratings agencies, or money brokers etc.

10.2 Starting Qualifications

There is a stated minimum level of qualification needed, as part of each job description for the various posts within the Investments team.

The Council recognises the importance that all treasury management staff should receive appropriate training relevant to the requirements of their duties at the appropriate time. The Council operates a (LMAR) system, which identifies the training requirements of individual members of staff engaged in treasury related activities.

Additionally, training may also be provided on the job and it will be the responsibility of the Director of Finance (Section 151 Officer) to ensure that all staff under his authority receives any necessary training.

10.3 Statement of Professional Practice (SOPP)

As a member of CIPFA the Director of Finance (Section 151 Officer) is required to be committed to professional responsibilities through both personal compliance and by ensuring that relevant staff are appropriately trained.

Other staff involved in treasury management activities who are members of CIPFA must also comply with the SOPP.

10.4 Details of qualifications & experience of treasury staff - As at January 2020

Investments Manager

- Has experience working within the financial and investment services industry in both the public and private sectors since 1996 and has been heading up the SCC Investments team since March 2003.
- Is a Chartered Financial Analyst and an Associate of the Society of Investment Professionals.
- Holds a BSc (Hons) degree in Accounting and Financial Analysis.

Principal Investment Officer

- Has worked in the SCC investments team since 1998, except for 2 years in the SCC internal audit team.
- Holds a BA (Hons) degree in Business Administration
- Is AAT qualified
- Holds the Investments Administration Qualification from the Securities Institute.

Senior Investment Officer

- Has worked in the SCC investments team since 2004, and for a further 7 years in various accounting functions of SCC
- Is AAT qualified
- Holds the Investment Management Certificate.

10.5 Records of training received by treasury staff

Formal records of training received by treasury staff are kept by the individuals involved. All course material is kept for as long as it is deemed relevant.

10.6 Records of training received by those charged with governance

All new Councillors receive an overview of the treasury management function as part of their induction.

Training opportunities for members are highlighted each year in the TMS. Invitations to attend CIPFA events relevant to Treasury Management are offered.

Records of any training received are to be kept by those charged with governance.

11.1 Details of contracts with service providers, including bankers, brokers, consultants, and advisers

11.1.1 Banking services

- Name of supplier of service is currently Nat West Bank
- The branch address is: 26-27 Fore Street, Taunton, TA1 1JQ
- Contract commenced 1 April 2015 and runs for four years with the option of a two-year extension. We are currently within the two-year extended period. Cost of service is variable depending on schedule of tariffs and volumes
- Payments due quarterly

A full tender conducted under EU procurement rules will be undertaken at the end of the current contract.

11.1.2 Money-broking services

In addition to direct dealing, the Council will use money brokers for temporary borrowing and investment and long-term borrowing. It will seek to give an even spread of business amongst the approved brokers where rates offered are the same, but the best rate achieved will be the primary factor.

The Principal Investment Officer, on an ongoing basis, evaluates the service levels of brokers and if rates are equal, the broker that has been offering the best service will be given the transaction. Contact with an approved list of brokers (below) is maintained. Appropriate recommendations to change the approved brokers list will be made to the Director of Finance (Section 151 Officer) at monthly TM meetings.

Current broker contacts: -

- Tullett Prebon
- Tradition UK Ltd
- Sterling International Brokers (Part of BGC Brokers)
- Intercapital (Europe) Ltd
- RP Martin
- Imperial Treasury Services

11.1.3 Consultants' / advisors' services

Treasury Advisor Services

Arlingclose were selected as Treasury Advisors to SCC In February 2009 and have retained the position since a full competitive tender in 2012. Under the schedule of services to be provided, they will: -

1. Provide assistance in compliance with the CIPFA Code of Practice on Treasury Management in respect of policy and strategy papers, Treasury Management Practice maintenance and the reports made to Committee, Cabinet, Scrutiny and Council.

2. Assist in the calculation and setting of the Council's Prudential Indicators.

3. Provide advice in monitoring the Council's internal treasury procedures.

4. Provide economic and interest rate forecasts.

5. Advise the Council on Investment Strategy and its execution.

6. Advise the Council on credit worthiness policy and reconciliation of Council's list of investment counterparties.

7. Hold an annual strategy and review meeting with the Council to set and review treasury strategy and monitor progress in response to changing economic, political and legislative events and circumstances

8. Provide advice and guidance within an agreed strategy on long-term borrowing as well as debt restructuring opportunities including the evaluation of the financial impact of activity on the General Fund in accordance with the Council's adopted treasury strategy, Prudential Indicators and relevant accounting standards.

9. Provide periodic reviews of progress and reassessment of the Council's financial objectives in light of prevailing interest rate forecasts, economic developments and any legislative changes that impact on management of the portfolio.

10. Assist in the monitoring of the Council's debt and investment portfolio performance.

11. Provide training opportunities to officers.

11.1.4 External Fund Managers

None used at present for Treasury Management purposes.

11.1.5 Credit rating agency

The Council does not subscribe to a credit rating service but has free access to much ratings information through registration with all three major ratings agencies, Fitch, Moody's, and Standard & Poor's.

12.1.1 List of documents to be made available for public inspection

The Council is committed to the principle of openness and transparency in its treasury management function and in all of its functions.

It has adopted the CIPFA Code of Practice on Treasury management and implemented key recommendations on developing Treasury Management Practices, formulating a Treasury Management Policy Statement and implementing the other principles of the Code.

The following documents are available for public inspection: -

- Treasury Management Policy Statement
- Treasury Management Strategy
- Investment Strategy
- Annual Treasury Outturn Report
- Mid-year Outturn Report

- Annual Statement of Accounts
- Annual budget
- 3-Year Capital Plan

- Minutes of Full Council meetings

12.1.2 List of external funds managed on behalf of others and the basis for attribution of interest and costs

SCC has a contract to provide treasury management services to the Police and Crime Commissioner for Avon and Somerset. It manages these funds on a segregated basis under contractual arrangements.

SCC manages funds on behalf of Exmoor National Park Authority, and South West Councils. These monies are managed on an aggregated funds basis in the name of SCC, under terms agreed in a Service Level Agreement with those bodies.

SCC manages funds of other public or not-for-profit organisations via the Comfund. Specified terms and conditions are agreed and signed by participating bodies.

SCC is the administering body for the Local Enterprise Partnership (LEP). Funds from Government are received into the SCC account, and paid out to LEP partners when expenditure claims are verified by SCC staff. Whilst LEP monies are under SCC stewardship, they are amalgamated with SCC funds and lent as part of SCC balances. Interest is paid to the LEP partners on balances held at the rate achieved by SCC minus a management fee.

TMP 13 INVESTMENTS THAT ARE NOT PART OF TREASURY MANAGEMENT ACTIVITY

SCHEDULE M

The Council recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes, requires careful investment management. Such activity includes loans supporting service outcomes, investments in subsidiaries, and investment property portfolios.

The Council will ensure that all its investments are covered in the Capital Strategy, investment strategy or equivalent, and will set out, where relevant, the Council's risk appetite and specific policies and arrangements for non-treasury investments. It is recognised that the risk appetite for these activities may differ from that for treasury management.

SCC recognises that many of the principles underlying TMPs 1 to 12 will apply to non-treasury investments as they do to treasury investments. However, some aspects are likely to differ significantly. It is impracticable to cover all non-treasury investment eventualities in a schedule, so at the point where Investments that are not part of Treasury Management activity are being actively considered, a detailed TMP schedule will be developed to accurately reflect the risks and mitigating actions of the investment(s) being considered.

1.13 List of currently approved counterparties and date of formal approval (Updated 11-07-2019)

Bank or Building Society	**Date Approved**	**Bank or Building Society**	**Date Approved**
Bank of Scotland Plc	01/01/2007	Bank of Nova Scotia	20-04-2016
Barclays Bank Plc	01/01/2007	National Australia Bank	20-04-2016
HSBC Bank Plc	01/01/2007	Canadian Imperial Bank of Commerce (CIBC)	10-11-2016
Lloyds Bank Plc	01/01/2007	DZ Bank	20-04-2019
National Westminster Bank	01/01/2007	Nat West and RBS formally reinstated after ring-fenced entities upgraded above SCC criteria	
Nationwide Building Society	01/01/2007		
Royal Bank of Scotland Plc	01/01/2007		
Santander UK	01/01/2007		
Australia & New Zealand Bank	17-07-2012	**Sterling LVCNAV Money Market Funds**	
Standard Chartered	13-09-2012	Goldman Sachs	26-06-2009
Svenska Handelsbanken AB	13-09-2012	Invesco Aim	29-06-2009
Nordea Bank AB	13-09-2012	Federated Prime	31-07-2009
Close Brothers Limited	02-05-2013	JP Morgan	09-10-2009
Deutsche Bank AG (Suspended)	22-08-2013	Insight	09-11-2009
Rabobank	22-08-2013	Standard Life (Was Ignis)	18-11-2009
Development Bank of Singapore	29-07-2104	ICS (Was Blackrock)	01-07-2011
United Overseas Bank	29-07-2104	Deutsche	01-07-2011
Goldman Sachs Investment Bank	29-07-2104	LGIM	23-02-2012
Oversea-Chinese Banking Corp	20-04-2015	SSGA	11-10-2018
OP Corporate Bank (Was Pohjola)	15-06-2015		
Commonwealth Bank of Australia	06-08-2015	**Other**	
Toronto Dominion	04-11-2015	DMO	05/02/2009
Landesbank Hessen-Thuringen Girozentrale (Helaba)	04-11-2015	Other Local Authorities	01/01/2007
Bank of Montreal	29-01-2016	CCLA Property Fund	26/04/2017

Certified by the Interim Director of Finance (Section 151 Officer)

........Shelton Collins.................... Date ..23.1.2020.......

And the Deputy S151 Officer

..........C. Ylw.................... Date ..23/1/2020........

APPENDIX 13

2023/24 Non-Treasury Management Investment Strategy

1. Background

1.1. The 2023/24 Non-Treasury Management Investment Strategy for the new Somerset Council is required to be considered by Somerset County Council as part of the 2023/24 budget setting process. This is a complex and highly regulated area of activity, and this strategy has been written to meet the relevant regulatory framework as set out in Annex 13C of this report.

1.2. Councils invest money for three broad purposes:

1) Because it has surplus cash arising from its day-to-day activities or cash that it holds pending its spending plans (known as treasury management investments).

2) To support local public services by lending to other organisations (known as service-based investments).

3) To earn investment income (known as investments made primarily for yield or commercial investments).

1.3. This investment strategy focuses on the second and third of these investment categories and together they are termed non-treasury management investments. The first category is considered in the 2023/24 Treasury Management Strategy. Whilst service investments and investments primarily for yield are entered into and managed outside of normal treasury management activities, the Treasury Management Strategy comes into play in their financing.

1.4. The objectives of this Non-Treasury Management Investment Strategy are to provide:

1) The proposed Strategic Objectives for 2023/24.

2) A high-level overview of the different types of non-treasury investments that will be held by Somerset Council on 1st April 2023.

3) The governance and reporting arrangements for these investments.

4) Management of the investments and the capacity, skills, and knowledge available to the Council.

5) The Annual Review of financial performance, as required under the revised Prudential Code, for 2023/24 of the net cost/return to the General Fund revenue budget of holding the investments for yield.:

6) An explanation of the relevant regulatory framework that needs to be considered when holding, managing, and divesting these investments.

7) An analysis of the associated risks and management's proposed mitigations including indicators which allow Elected Members and the public to assess the level of risk involved.

1.5. Proposed 2023/24 Strategic Objectives

Strategic Objective 1: Ensure the Council has flexibility and choice in obtaining loan finance.

Policy commitments and detailed objectives:

- Ensure the Council meets the criteria for accessing the Public Works Loan Board (PWLB) by not acquiring any new investments that fall within the definition "investments primarily for yield".

Strategic Objective 2: Ensure the investments for yield continue to contribute to the Council's overall financial health.

Policy commitments and detailed objectives:

- Retain the current investments made primarily for yield that will be vested to Somerset Council from the predecessor councils on 1st April 2023 for the immediate future.

- Ensure effective arrangements are maintained to collect all income due in a timely manner, and actively manage tenancy and lease arrangements to minimise losses through voids and/or non-collection of rents and service charges.

- Undertake regular modelling of the net return being achieved and forecast from holding these investments for the portfolio as a whole and for individual properties and from both the shorter and the longer-term viewpoint.

- Establish objectives, aims and expectations around the contribution being targeted from investments for yield.

- Maintain a proactive knowledge of the state of the UK commercial property market.

- Undertake regular reviews of relevant risks and mitigation options.

- Review opportunities for new permitted investment in existing investments to maximise the net return and/or improve the asset value (within acceptable risks).

- Review opportunities for selling the investments to maximise the overall net return, or to minimise future risks (such as reducing the Council's exposure in a particular market sector or geographic location), or to generate capital receipts.

- Review options available to the Council to finance the remaining indebtedness that has arisen from purchasing these investments to maximise the net return or to minimise future risks.

- Obtain relevant expert advice, when needed, to achieve these objectives.

Strategic Objective 3: Ensure commercial property investments are attractive in the market

Policy commitments and detailed objectives:

- Develop a Property Investment Strategy to ensure:
    - Properties remain attractive to tenants for letting and, at least, maintain their investment value.
    - Properties are fit for purpose, safe, and compliant with relevant legislative requirements.

- Review the costs of achieving a) and b) above with the potential return obtainable and the impact on other capital financing needs.

2. Investments Primarily for Yield

Background

2.1. The four predecessor district councils in Somerset all established programmes of investing for the primary purpose of making a yield. Most of the activity focused on acquiring commercial property. Many other councils across the country have also pursued this strategy with levels of local authority investment increasing more sharply in recent years across the sector.

2.2. The net returns make a significant contribution to the funding of the four councils' General Fund revenue budgets because the additional income generated exceeded the returns the councils were able to get with their cash investments and more than covered the costs of any short-term and longer-term borrowing undertaken to fund the capital acquisition costs.

2.3. The primary objective for all four councils was to generate new income to enable them to continue providing essential council services to their communities at a time of declining financial support from central government, and where risk and uncertainty of funding remains high (notably, Government grants and business rates). This was achieved.

2.4. The four councils viewed these acquisitions as long-term investments that would be proactively managed by having the flexibility to respond fluidly to opportunities and changes in the economy, the market, and differing performance across asset classes. The ability to sell properties to reinvest is a common portfolio investment tool in the private sector which helps achieve higher net returns whilst also mitigating risk.

2.5. However, since the strategies were implemented, there have been several changes to the regulatory and economic background that have significantly impacted on this investment activity (see Annex 13C for the detail):

a) Changes were made to the PWLB (Public Works Loan Board) terms of lending effectively making it inaccessible for councils who continue acquiring investments made primarily for yield.

b) Changes made to the Prudential Code also prohibited acquiring investments primarily for yield with councils needing to pay "due regard to" the guidance as required by legislation.

c) Other changes made to the regulatory framework now prohibit councils using the sales proceeds from selling these assets to fund new investments for yield. This means that the approach private property fund managers undertake in selling and repurposing the proceeds to acquire better performing and/or less risky assets cannot now be undertaken by councils.

d) Unfavourable and very rapid changes to the economic situation, particularly the rise in interest rates during the 2022/23 financial year and the risk of a recession, are putting pressure on the investments achieving a net rate of return in the short and medium term and potentially increase the risks involved in holding these investments.

2.6. Given that PWLB loan finance represents a relatively cheap and easy-to-access source of long-term borrowing, as compared to other often more complex sources of loan finance, it is being recommended in this strategy that Somerset Council ensures it has access to the PWLB if needed and therefore does not undertake any new acquisitions that fall within the definition of "investments primarily for yield".

2.7. The Director of Finance and Governance can confirm that the proposed Capital Budget for Somerset Council for the period 2023/24 to 2027/28 does not contain any budget for acquiring investments primarily for yield.

2.8. The portfolio of investments made primarily for yield is therefore now complete. The focus for Somerset Council will be on proactive management of the investments and associated risks within the regulatory framework as set in the proposed Strategic Objectives shown in paragraph 1.5 of this report.

Commercial Property Acquisitions and their financing

2.9. The period over which these investments were acquired is shown below. No further investments meeting the definition "investments primarily for yield" were acquired after December 2021 when the revised Prudential Code came into effect:

- Mendip District Council: October 2017 to November 2019
- Sedgemoor District Council: December 2018 to December 2020
- Somerset West & Taunton District Council: August 2020 to December 2021
- South Somerset District Council: November 2017 to December 2021.

Table one: Acquisition costs and financing (£000s)

Figures are in £000s	Mendip	Sedgemoor	Somerset West & Taunton	South Somerset	Total
Investment made	50,401	46,500	98,965	93,224	289,091
Funded by:					
Capital Receipts				4,000	4,000
Revenue resources			3,520		3,520
Long term borrowing	50,401				50,401
Short/internal borrowing		46,500	95,445	89,224	231,170

2.10. The councils financed their investment acquisitions through a variety of ways. Most of the funding however was by means of borrowing. Mendip District Council financed their investments through taking out several long-term loans whilst the other three predecessor district councils financed their investments through a mixture of revenue funds, capital receipts, internal borrowing, and shorter-term external loans.

Overview of the commercial property portfolio

2.11. The new Somerset Council inherits a diversified property portfolio, with a balanced spread between asset classes and geographical locations which will help mitigate the potential risk of holding assets all in one sector and/or location.

2.12. The following paragraphs and charts aim to illustrate key aspects of the investments held.

Chart One: Commercial property investments key metrics

Capital investment made £289m

Individual investment value from £0.7m to £22m

48 properties

36 out of Somerset

17 multi let

31 single let

96 tenants

Currently 6 voids

Average income per tenant £209k

Gross average yield 7.5%

Average WAULT 6.45 years

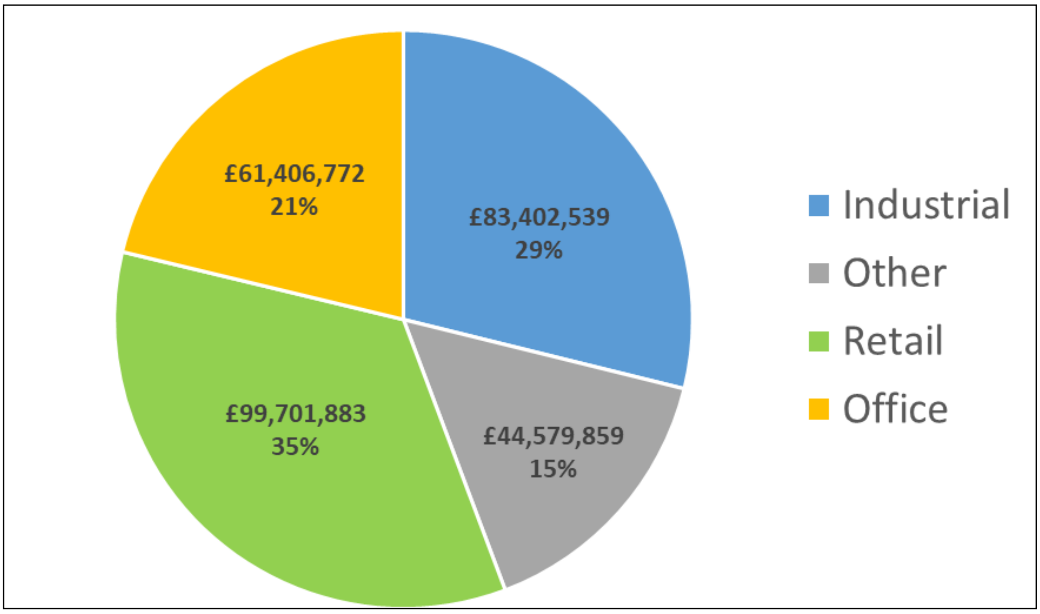
Gross rental income (2023/24) £20m

Direct holding costs (excluding officer time & financing charges) £0.8m

WAULT = weighted average unexpired lease term
Gross Yield = Contracted income return percentage on purchase price

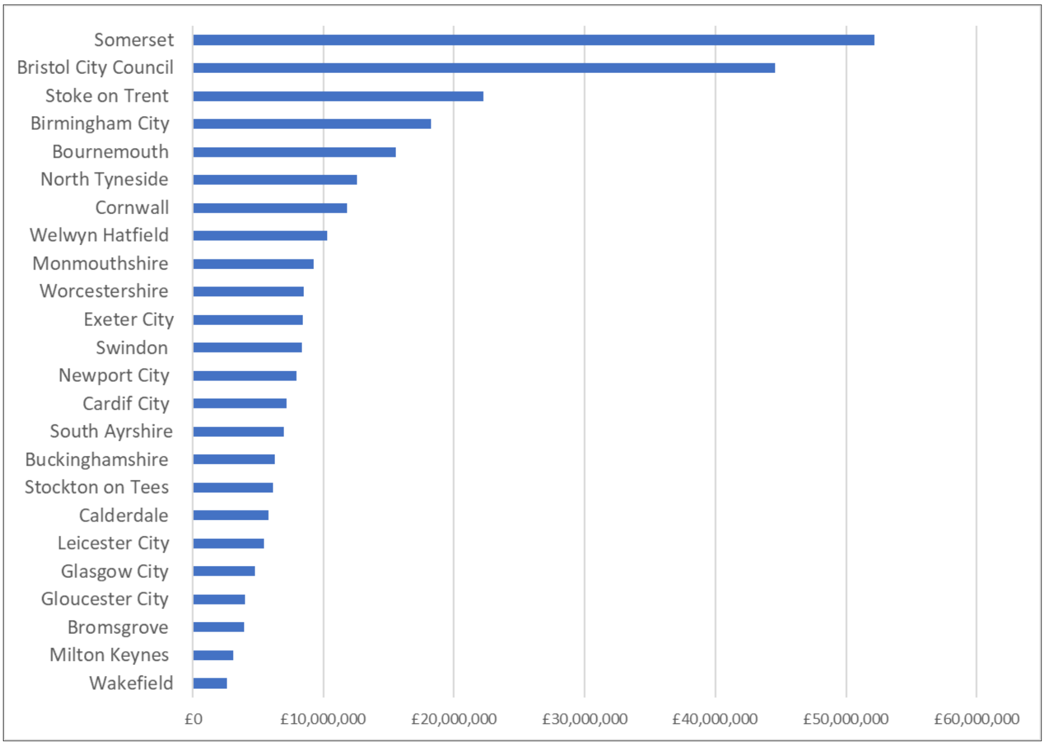
2.13. Property sectors: The portfolio is weighted towards retail and industrial asset classes. 35% of the investment has been made in the retail property sector followed by industrial (29%), office (21%), and the other property sector (21%). investments made in the latter include: a healthcare centre, a gym, and an NCP car park. Of the retail property, 25% can be regarded as high street / town centre retail.

Chart Two: Investments made per property sector (asset classes)



2.14. Location of the investments: 75% of the properties held are located out of Somerset Council's area. By value, £237m (or 82%) of the total investment that has been made is outside of the new council boundary. Chart Three shows the value of investment made across the United Kingdom.

Chart Three: Property investment made per local authority area



2.15. Average size of investments: The average acquisition price was £6.023m with 48% of the £289m invested being on properties acquired within the £5m to £10m range. The largest acquisition of £22m was made for an industrial property in Stoke-on-Trent.

Chart Four: showing size of investments made (numbers = no of properties)

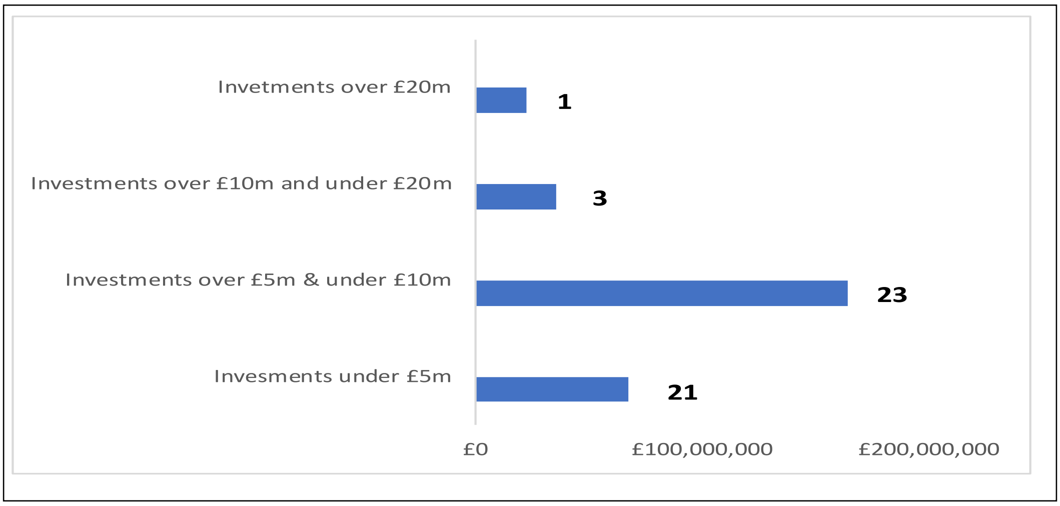
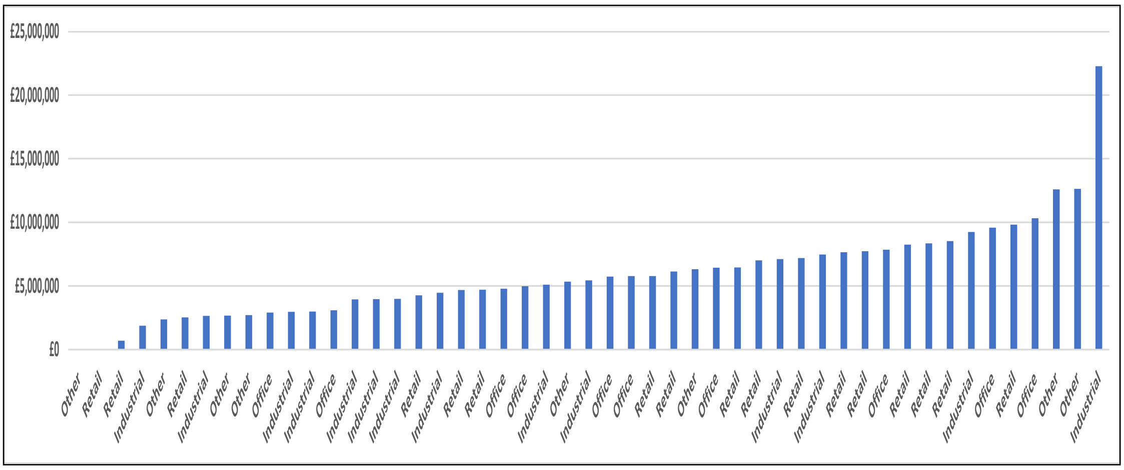
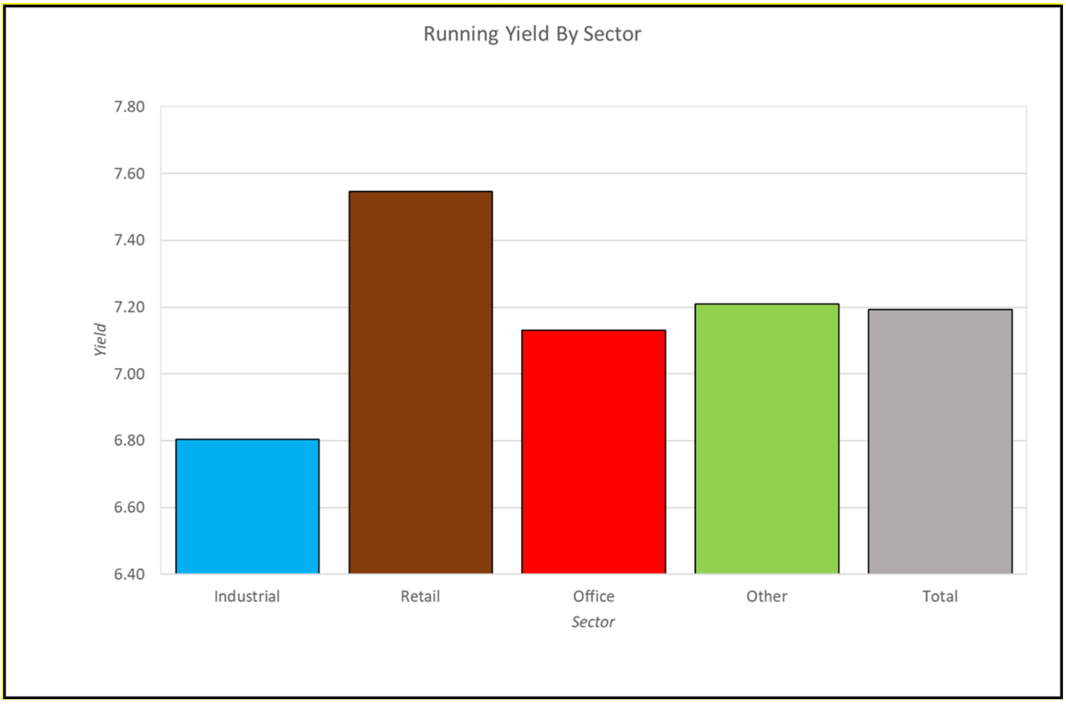


Chart Five: Acquisition cost per property



2.16. Gross yield: (which is the gross current income divided by the investment purchase price) by property sector shows the initial return the contracted rents provide split by district council and by investment sector.

Chart Six: Gross Yield % per property sector



2.17. Investment value: The unaudited value of the commercial property investments as at the end of March 2022 is £264m. As compared to the total investment made (£289m) this is a decrease in value of £25m (9%) but one-off costs of purchase (fees and SDLT) account for most of this difference. A new valuation will be undertaken to produce the 2022/23 Statement of Accounts. It should be noted that £15m of the indebtedness arising from purchasing these assets has already been paid by the predecessor councils through Minimum Revenue Provision (MRP) payments from their revenue budgets.

2.18. Security, liquidity, and yield: The principles of security, liquidity, and yield must be considered when making any investment. When considering treasury management investments, security is the highest priority, followed by liquidity, and yield is a low priority. However, the objectives for investing primarily for yield (i.e. to make a return to support the funding of core council services) has meant that such investments have not always prioritised security and liquidity as highly as treasury investments do.

2.19. Commercial property is not a liquid investment, such as a bank account where one can withdraw needed cash immediately. They can take significant time, and cost, to sell and are only divisible by the individual ownership components. A reasonable rule of thumb is to allow up to 6 months to dispose of an investment property.

2.20. **SSDC Opium Power Ltd (SSDC OPL):** As part of its commercial strategy, the predecessor South Somerset District Council, invested £42m through a joint venture company, SSDC OPL, in a design, build, finance and operation of battery energy storage systems (BESS) at Taunton, Somerset (SSDC OPL) and at Fareham, Hampshire (FERL 1 and 2).

2.21. The current structure of the JV comprises a parent company, SSDC Opium Power Ltd (SSDC OPL) and two subsidiary companies, Fareham Energy Reserve Ltd (FERL 1) and Fareham Energy Reserve 2 Ltd (FERL 2). There are 100 shares in SSDC OPL: the Council holds 50 and OPL holds 50. All the shares in FERL 1 and FERL 2 are held by SSDC OPL.

2.22. The returns from these investments come by way of interest on the capital lent by SSDC to the joint venture company, and dividends from the profits of the company. In addition, the loan repayments are used to fund the capital budget thus reducing the Council' s overall borrowing needs.

Table Two: loans made to SSDC Opium Power Ltd and subsidiaries

Amount Lent	Loan Date	Interest rate	Loan Period	Maturity date
9,840,000	17/05/2018	5.00%	8.25 yrs	31/07/2026
1,284,000	29/03/2019	5.00%	7.35 yrs	31/07/2026
2,033,055	15/08/2019	7.50%	7 yrs	31/07/2026
13,157,055	Total Loan to SSDC Opium Power Ltd			
18,690,560	20/10/2020	4.00%	25 yrs	01/01/2047
18,690,000	Total loan to FERL 1			
10,318,980	26/05/2021	4.00%	25 yrs	01/04/2048
10,630,877	Total loan to FERL 2			
42,477,932	**Total loan to SSDC OPL and subsidiaries**			

2.23. The loan balance at the end of March 2023 is forecast to be £39m. £3m of the £3.7m scheduled loan repayment for 2022/23 has already been paid (as at the time of writing this report).

2.24. As these projects needed to be constructed prior to any trading, there was an initial period of investment without immediate return. Taunton was completed in 2020, FERL 1 was completed in February 2022, and FERL 2 reached completion in June 2022. The project on this last facility is completing all its technical tests and will shortly start trading.

2.25. SSDC Opium Power Ltd started to generate a profitable trading position during 2020/21. Under the provisions of the Shareholders' Agreement for SSDC OPL any dividend payment requires express consent from the Council. For Taunton, there can be no dividend until the loans are repaid in full. Profits made to date have been used to accelerate the repayment of the loans provided by the Council. The dividend share is 50:50 between the Council and the other shareholder (OPL).

2.26. FERL 1 began to trade during 2022. Loan repayments are being made in accordance with the minimum amounts set out in the loan agreement, leaving a surplus in the company. Any profits are shared 65:35 in favour of the Council. As at the time of writing this report, the predecessor council is considering its position on whether to take a dividend or require the profit to service the earlier repayment of the loan debt outstanding.

2.27. FERL 2 has similar arrangements to FERL 1 other than the profit shares being 70:30 in favour of the Council.

2.28. **Security, Liquidity, and Yield**: The arrangements involve substantially more complexity than the property investments with the company structure, separate accounting and governance, and the need for the Council to appoint Directors to the Board. This investment sector is very specialised requiring niche advisory providers and is focussed on an emerging market which should be viewed as riskier.

2.29. However, the loan principal and interest are being paid in line with the agreed loan schedule. The current income returns to the company are well above the forecasts made when the lending was approved, but this trading information cannot be disclosed in a public report. The investment, like the commercial property portfolio, is not particularly liquid.

3. Investments made for service purposes

3.1. The predecessor councils have lent money to businesses, charities, housing associations, and other public bodies to support their service objectives. The table below shows the service investments (which are in the form of loans) the new Council will inherit on 1 April 2023 (unless any are redeemed early).

Table Three: Service Investments held by Somerset Council

Sector	Total Loan amount £	Financial Year(s) given	Total Balance as at 1/04/23 £	Length of loan period(s) remaining	Interest rate(s)
Registered Housing Association	117,810	1971/72	44,500	10 years	2.84%
Registered Society	1,684,900	2014/15 2015/16 2021/22	1,020,124	7 years	Various 3.49% - 4.89%
Charities	3,566,646	2017/18 2019/20	3,341,363	2- 26 years	Various 2.57% - 4.5%
Local Business	500,000	2018/19	400,223	14 years	3.75%
Council subsidiary	419,000	2015/16 2018/19 2019/20 2020/21	1,320,661	22 -27 years	Various 1.11% - 5.04%
College	4,500,000	2019/20	4,176,577	17 years	4.50%
Local Business	190,000	2015/16	88,890	13 years	2.76%
Schools	271,424	various	TBC	various	0%
	11,249,780		**10,392,338**		

3.2. Members may also wish to note that the Councils currently hold inter-authority service loans, for example in respect of loans provided by the district councils to SCC towards funding capital investment in the Somerset Waste Partnership. When the councils merge to form the new unitary authority on 1 April these loans will be cancelled, leaving the ongoing capital financing requirement to be financed through future treasury management.

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. However, the total risk exposure to service investments is currently £10.4m, which is not considered to be disproportionate to the overall size of Somerset Council.

3.4. Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figure for any loans in the statement of accounts at the end of 2023-24 will be shown net of this loss allowance. However, up to this point in time no loss or impairment of these loans has had to be made.

3.5. **Liquidity**: These investments are not liquid as the repayments are made in line with agreed loan agreements. Table Three shows that most of the outstanding current debt will not be fully repaid before fifteen years.

3.6. **Yield**: In view of the public service objective, the yield obtained from the service investment has not always been the primary consideration.

Policy for granting service loans

3.7. Whilst given the public service objective, the Council is willing to take more risk than with conventional treasury investments; any decisions on granting such loans will be made on the basis that repayment to the Council remains a firm, secure, and realistic commitment from the applicant.

3.8. The yield obtained will not always be a primary consideration, but the Council will normally seek to at least cover its own financing costs in funding the loan and will pay due regard to market rates.

3.9. The Council may also from time to time make Soft Loans (loans charged at interest rates at less than market value). Before such loans are undertaken, the implied subsidy will be clearly identified and quantified as part of the decision-making process.

3.10. All loan requests must be set out in a Business Case from the sponsoring service demonstrating how the loan will deliver service outcomes.

3.11. Due diligence will be undertaken by carrying out a proportionate review of the credit risk of the applicant, a review of its published financial statements, and the Business Case detailing how the loan will be used.

3.12. Where deemed necessary (for example where a large loan request has been made) the Council will seek a legal charge on the underlying assets of the applicant to mitigate against the risk of the applicant defaulting on the loan.

3.13. All service investment requests will be considered in the context of the impact on the cumulative total of all such loans made by the Council and any implications for the its shorter and longer-term cash flow requirements.

3.14. Total exposure for service loans will be contained within the prudent limit set within the Treasury Management Strategy.

4. Governance and reporting arrangements

4.1. In line with legislative requirements this Investment Strategy will be prepared annually and will be approved by full Council as part of the wider budget setting process.

4.2. The Audit Committee is responsible for reviewing this Investment Strategy, recommending the strategy to Council for approval. It will receive a Mid-year Review Report and an Outturn report which are also reported to Council.

4.3. Monitoring of the budgets associated with these investments (for example, the rental income received compared to budget) will be included in the quarterly corporate budget monitoring report to Executive.

4.4. A review of the financial performance in terms of the net return being achived will be undertaken and reported quarterly in a separate report to Executive.

4.5. Significant information about the investments is required to be disclosed annually in the Statement of Accounts. This is subject to external audit.

4.6. Further appropriate governance arrangements will be put in place as part of the work on the constitution and democratic arrangements.

Officer delegation:

4.7. The Executive Director of Resources & Corporate Services (s151 Officer) has the overall responsibility for delivering the agreed Non-Treasury Management Investment Strategy and the 2023/24 Strategic Objectives.

4.8. Appropriate delegations will be made to the Service Director - Strategic Asset Management and the Service Director – Finance & Procurement to support delivery.

5. Management of the investments, capacity, and skills

5.1. **Property Portfolio Management:** In terms of day-to-day resource requirements and officer focus, the commercial property portfolio and SSDC OPL will need more proactive management than the other non-treasury management investments.

5.2. The four predecessor districts approached portfolio management in a broadly similar way and managed single-let properties in-house with multi-lets managed via external agents with service charge administration costs recovered from tenants. Managing multi-tenanted property is more complex and time consuming that managing single let property.

5.3. Investment property asset management is an area of experience not held by some local authority property specialists. Currently, there are only two investment specialists employed within the predecessor councils.

5.4. At the time of publication of this report, Somerset Council is very much in a transitional phase, with appointments to the tier 3 structure unlikely to be in place in January 2023 and with a clear position from the Chief Executive that the development of detailed structures beneath tier 3 will not be taken forward until service directors are in position.

5.5. It is not possible therefore to give details of the arrangements that will be available to manage the commercial property portfolio apart from the fact that it will fall within the service area for the Service Director - Strategic Asset Management. Sufficient budget for the staffing establishment, advisers and the range of consultancy costs must be retained so that good practice management delivery can be achieved as that is critical to income performance and protecting value.

5.6. The objectives for the management of the commercial property investments will be to:

a) Ensure that the Council has a fully resourced, proactive, and professional management in the handling of its commercial property to optimise the value of the investments and rental income over time. The evaluation of the mix of in house and external resources is in hand but not yet completed.

b) Modernise asset records and systems to ensure the efficient management and recording of property/tenant data and lease renewal dates to aid the timely collection of rents and service charges.

c) Ensure Property Finance management is a focussed activity with sufficient resources to deliver ongoing financial due diligence, monitoring and reporting, and to support decision making. This is a critical resource requirement due to volume and value of financial transactions involved with the portfolio, and the specialised requirements.

d) Develop a unified policy on the approval and giving of discounts and incentives, deposit management, debt collection, and write-offs.

e) Ensure effective budgetary control of the Council's financial position through completion of realistic prudent budget estimates and ongoing review of income, debt levels and void rates.

f) Undertake yearly valuation of investment assets.

g) Undertake effective rent reviews, re-gearing of leases where appropriate, or remarketing of lease opportunities in a timely and market-focused manner.

h) Undertake tenant vetting prior to a new lease being granted to minimise credit and default risk.

i) Ensure tenants fulfil their repair and maintenance obligations of their lease including dilapidation on termination.

5.7. **Skills and knowledge available:** The Executive Directorate of Resources & Corporate Services will include officers who are qualified chartered accountants and chartered surveyors.

5.8. Ongoing treasury management advice and taxation advice will be provided by specialist advisers to the Council.

5.9. The Council will use valuation experts to value Property, Plant and Equipment and Investment Properties. Expert advice will also be procured to value SSDC Opium Power Ltd battery storage assets which require very specialised advisers.

5.10. The portfolio management approach is being reviewed. Options will be presented with recommendations. Any internal appointments and external advisers can then be appointed and transition from existing arrangements and contracts completed.

5.11. Other specific advice will be procured as and when needed. There will be significant property legal resource requirements. The resourcing approach will need to be agreed and put in place.

5.12. The Council will ensure that appropriate training and learning is given to all officers involved in this area of work.

5.13. It is important that elected members understand the decisions they will be asked to make relating to these investments and indeed this is a regulatory requirement in CIPFA Prudential and Treasury Management Codes.

5.14. To ensure that members have the knowledge and skills required to support them in their decision-making role, a series of training events will be developed during 2023/24 which will cover the relevant knowledge areas.

6. Financial Performance of the investments made primarily for yield

6.1. Financial modelling has been undertaken to determine the net impact on the Council's General Fund revenue budget of holding these investments after considering the financing costs that can be reasonably associated with the borrowing undertaken to fund their acquisition.

6.2. Borrowing is of three types:

- Internal borrowing – using available cash to purchase the investment instead of putting the cash into the bank or other savings accounts. The use of this cash is temporary as it needs ultimately to be used for its intended budgeted purpose.
- Short term borrowing, generally a year or less, from external institutions.
- Longer term borrowing from external institutions, for example the Public Works Loan Board (PWLB) with lending available for up to 50 years.

6.3. Other longer term financing options may be available such as leases.

6.4. Local government does not borrow specifically for a particular capital purchase of an investment unlike, say, a homeowner who obtains a mortgage to fund a particular property.

6.5. This makes it difficult to be precise about what sort of borrowing has been undertaken in respect of financing these investments as compared to the rest of the capital programme. Mendip District Council obtained longer-term loan finance whilst the other three councils used internal borrowing and short-term loans in different proportions which changed over time.

6.6. A pragmatic view has been taken by calculating the proportion of the Capital Financing Requirement (CFR) (the amount of indebtedness held by the predecessor councils) arising from these investments as a percentage of the overall indebtedness incurred by funding their capital budgets. This amount has then been reduced to take into account the MRP (Minimum Revenue Provision) payments made by the councils since the investments were acquired (by £15m) which has reduced the indebtedness held.

6.7. This CFR position is used as the starting point to analyse whether the gross rental income is sufficient to cover the 2023/24 and future years' financing charges arising from this inherited indebtedness position. Current and forecast interest rates are used as well as the new Council's proposed MRP Policy.

Other key assumptions made:

6.8. The worst-case position for borrowing: that is the Council takes out loan finance from the PWLB rather than uses its own cash or short-term borrowing - both of which would have lower interest rate implications than PWLB borrowing. In practice the Council may not be able to use PWLB for a significant proportion of refinancing and will instead prioritise other options such as loans from other local authorities which tend to be cheaper than PWLB.

6.9. An average interest rate of 4.5% is currently being used for budget estimates, derived from assuming PWLB borrowing over a 50-year period. Further work is required to quantify a blended notional interest rate that reflects the Council's overall approach to treasury management.

6.10. The interest rate forecasts for 2024/25 use advice received from Arlingclose, the Council's Treasury Management advisers, and is based on their assumption of declining interest rates from 2024/25 and onwards. More detailed advice from the advisers on interest rates is given in the 2023/24 Treasury Management Strategy.

6.11. MRP costs of 2% on an Equal Instalments Basis. Further work is needed to finalise the MRP Policy and select a calculation method that reflects a prudent approach for this type of activity and is acceptable both to the S151 Officer and the Council's external auditor.

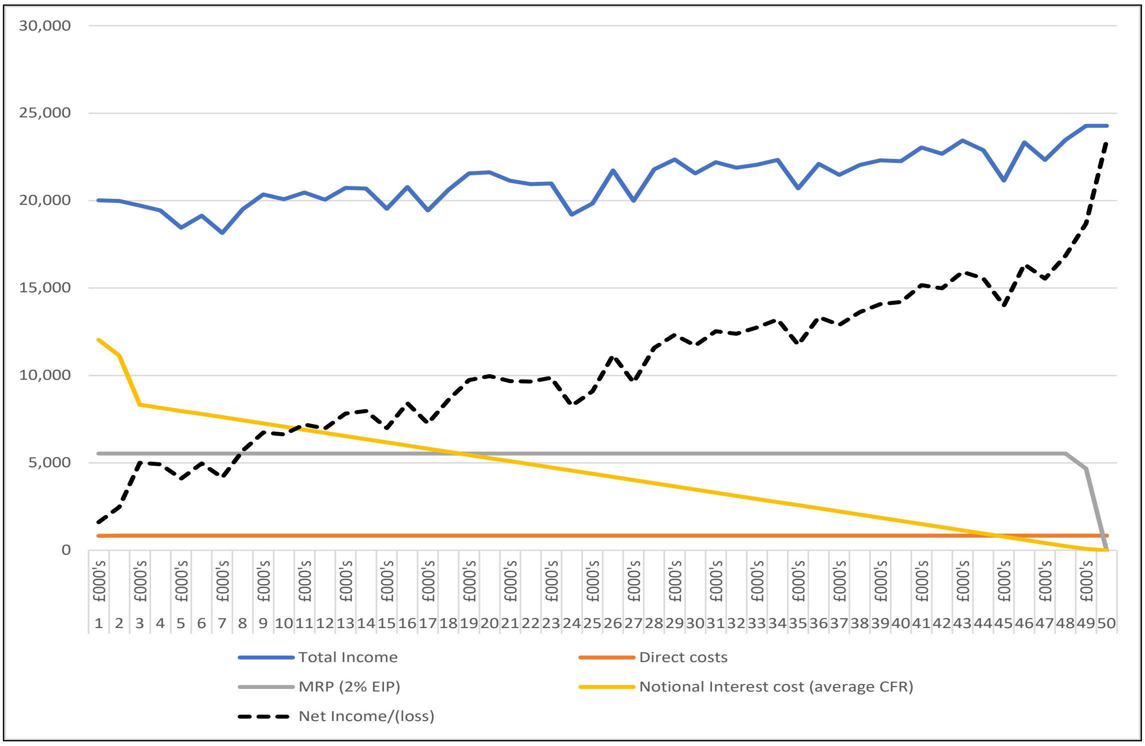
6.12. Financing costs are expected to reduce as the overall balance of CFR reduces each year. Costs will vary depending on the CFR balance and the interest rates than can be obtained each year.

6.13. Rental income is assumed to increase by 2% in a five yearly cycle. This is considered a prudent estimate for forecasting the average direction in the property market erring on the side of caution.

6.14. A cautious allowance has also been included in the model for void periods and the potential need for incentives such as a rent-free period for new tenants.

6.15. An assumption that the six properties that are currently void remain so over the modelling period, although all appropriate steps are being taken to improve on this assumption.

Chart Seven: Base mode in £000s (using Arlingclose interest rate forecasts)



6.16. Chart Seven above shows a fifty-year net income forecast (the dotted line) given the assumptions listed in the paragraphs above. (Year 1 is 2023/24). Rising interest rates are currently putting pressure on the investments achieving the net returns originally experienced when they were acquired.

6.17. The analysis shows that an estimated net return of 0.8% is forecast to be made in 2023/24 from the commercial property investments. This is at the overall portfolio level and is the estimated surplus after covering direct management costs, interest costs, and debt repayment. The net return however is very sensitive to interest rate changes and forecast rates going forwards. A 0.5% increase in interest rate assumption decreases the net return to 0.3%.

6.18. Net returns have also been calculated for each individual investment (not shown in this report), although the nature of the spread of investments means the return will vary from asset to asset based on many factors. The range is a negative 0.8% to a positive 4.5%, with 12 out of the 48 investments currently showing a negative return.

6.19. Chart Seven shows that the longer these investments are held, and as the outstanding debt is repaid off, the net return should increase. However, this analysis does not factor in potential risks relating to the individual investments (apart from potential void and rent-free periods) such as landlord capital costs and property obsolescence, nor the risks at portfolio level such as further legislative changes limiting local government holding these investments. A discussion of the potential risks associated with these investments is given in Annex 13B of this report.

6.20. Whilst the overall conclusion from this financial analysis is that Somerset Council retains these investments immediately post vesting day: both the financial and property officers involved in this work could propose individual investments that would be more obvious candidates for selling should the Council wish to consider this post vesting day. A key further element of work that would be needed however to take this forward would be to obtain a more recent valuation of the individual investments before taking a final decision. The latest valuations date from the end of March 2022.

6.21. Regular review of the net return position for the portfolio as well as the individual investments will be needed post vesting day as proposed in strategic objective 2 (paragraph 1.5).

ANNEX 13A: INVESTMENT PRUDENTIAL INDICATORS

Investment cover ratio:

This ratio shows how many times the total net income from non-treasury management investments relating to the Investment Properties can cover the interest costs associated with the outstanding indebtedness that has arisen from funding these investments. This demonstrates the Council's ability to service this indebtedness.

Table: Four Investment Cover ratio: times interest cost covered by income					
Year ended	Gross Income	Direct costs	Net Income	Interest cost	Cover ratio
	£000's	£000's	£000's	£000's	Times
31/03/2024	20,015	840	19,175	12,033	1.6
31/03/2025	19,977	840	19,136	11,129	1.7
31/03/2026	19,712	840	18,872	8,331	2.3

Loan to value ratio:

This is the amount of indebtedness currently held compared to the total asset value. In this instance, the asset value is the total value of the Council’ s property investments made primarily for yield. This illustrates whether the Council has assets of sufficient value to repay debt if required.

It should be noted that the Asset Valuation is the latest one undertaken, as at 31 March 2022. The next valuation will be undertaken for the 2022/23 Statement of Account (as at 31 March 2023) and is not yet available.

Table Five: Loan to Value ratio: % Closing CFR to Asset Valuation			
Year ended	Closing CFR	Asset Valuation	Cover ratio
	£000's	£000's	%
31/03/2024	264,628	264,167	100%
31/03/2025	259,097	264,167	98%
31/03/2026	253,566	264,167	96%

Total investments made primarily for yield as a proportion of total capital financing requirement (CFR):

This shows how much of the Council’ s overall CFR (indebtedness) (excluding Housing Revenue Account CFR) pertains to property investments made primarily for yield.

Table Six: % Property Investments CFR to Total CFR			
Year ended	Closing CFR	Total CFR	Cover ratio
	£000's	£000's	%
31/03/2024	264,628	1,022,100	25.9%
31/03/2025	259,097	1,031,000	25.1%
31/03/2026	253,566	1,015,700	25.0%

Income returns:

Net revenue income from commercial properties compared to the value of the property investment portfolio. This represents the yield of the portfolio as a whole – generally, the higher the percentage the better the performance of the portfolio. However, the better the quality of the asset and the tenant, the lower the yield is likely to be. Therefore, a balance needs to be struck between high yield and good quality assets.

Table Seven: Income return: % net compared to Asset Valuation			
Year ended	Net income	Asset Valuation	Cover ratio
	£000's	£000's	%
31/03/2024	1,611	264,167	0.61%
31/03/2025	2,476	264,167	0.94%
31/03/2026	5,010	264,167	1.90%

It should be noted that the Asset Valuation is the latest one undertaken, as at 31 March 2022. The next valuation will be undertaken for the 2022/23 Statement of Account (as at 31 March 2023) and is not yet available.

Gross and net income:

The income received from the Council' s investment portfolio at a gross level and a net level (after the deduction of operating costs, interest & MRP). These figures have been incorporated into the 2023/24 and MTFP revenue budget estimates.

Table Eight: Gross & Net income			
Year ended	Gross income	Net income	Cover ratio
	£000's	£000's	%
31/03/2024	20,015	1,611	8.1%
31/03/2025	19,977	2,476	12.4%
31/03/2026	19,712	5,010	25.4%

Net Commercial Income to Net Service Expenditure:

This indicator measures the Council' s dependence on the income investments made primarily for yield to deliver core services. It indicates proportionality and whether the authority is taking too much risk in aggregate.

Table Nine: Net Income to Council's Total Net Service cost			
Year ended	Net income	Net Service cost	Cover ratio
	£000's	£000's	%
31/03/2024	1,611	494,820	0.33%
31/03/2025	2,476	542,070	0.46%
31/03/2026	5,010	588,000	0.85%

ANNEX 13B: RISK ANALYSIS AND MITIGATION MEASURES

Risk appetite: can be defined as "the amount of risk that an organisation is prepared to accept, tolerate, or be exposed to at any point in time". Risk always exists in some measure and can never be totally removed.

The new Somerset Council will need to develop its risk appetite regarding these investments. This will be facilitated by the establishment of an Investment for Yield Performance Review Board as proposed in a previous section of this report. This section on risks applies to all the non-treasury management investments.

At the time of writing this report, it has been assumed that Somerset Council will accept these potential risks at vesting day. The rest of this section describes the key risks involved, giving a monetary value for the total risk exposure, where possible, the likelihood of the risk happening (High, Medium, Low), and proposed mitigation measures.

The potential risks involved can be broadly categorised into two major areas:

- Potential risks at the individual investment and overall portfolio level.
- Potential risks arising from economic and legislative changes

Each predecessor district council built up earmarked reserves to help finance the cost of the potential risks should they arise. It is estimated that the four districts will transfer around £10m in reserves for this purpose on 1 April 2023. This represents some 50% of the 2023/24 gross annual rental income budget from the commercial property investments. A full review of the reserves position will be undertaken during 2023/24.

Potential risks at the individual investment and overall portfolio level:

Risk that loans made to 3rd party organisations are not repaid

Likelihood: This is considered low risk for service investments given the nature of the organisations the predecessor councils have lent to. In terms of SSDC Opium Power Ltd (SSDC OPL) it is considered to be low to medium as the loan is secured against the assets, principal repayments are being made in line with the loan agreement, and two out of the three companies are now trading at a profit.

Total risk exposure: For service investments - £6.6m.
For loans made to SSDC Opium Power Ltd and subsidiaries - £39m.

Risk Mitigation: For new service lending this will include undertaking proportionate:

- Credit rating checks
- Analysis of the financial health of the organisation
- Review of the Business Case on how the loan is to be used
- A consideration of a legal charge on the borrower's assets
- Risk Mitigation for SSDC Opium Power Ltd and subsidiaries:
- Lending secured against the assets of the companies.
- Active involvement and monitoring of the JV company is a fundamental mitigation to protect the lending and value of the shareholding.
- Suitable governance for selection of Council appointed directors.
- Monitoring that joint venture companies are correctly resourced in terms of management, advisers, and contractors.
- Appointment of appropriate expert advice when required.
- Full records and documentation for use of Council and compliance with Council

accounting, standards, and procedures.

Risk that there are void rental periods

Description: Voids arise from having the property vacant (end of lease and inability to attract a new tenant, or tenant bankruptcy) or from negotiated rent free periods. The former the situation would mean not only the loss of rental income but the requirement to cover property costs such as Business Rates, void service charges, insurance, and security.

Voids frequently require some landlord capital spend to protect the long-term performance of the asset and achieve the best outcome on re-letting. There are fees to be met for letting agents and lawyers. Most new leases include a rent-free period as part of the letting package. Attempts to depart the normal mix of rent levels, lease terms and incentives are likely to frustrate the ability to re-let.

Likelihood: Low/medium: Currently there are six void properties. Most of the properties acquired are below £10m which means less risk of a single large tenant failing.

Total risk exposure: The current gross rental income is £20m.

The table below shows when leases end over the next few years and the rental income that would be at risk if a new lease is not obtained.

Table Ten: Lease end dates over the next few financial years

Financial Year	No of Properties	Rental income at risk £000's	% of overall income at risk
2022/23	9	£966	5%
2023/24	8	£1,388	7%
2024/25	8	£1,012	5%
2025/26	11	£2,533	13%
2026/27	14	£3,072	15%
2027/28	8	£1,622	8%
2028/29	7	£1,358	7%
2029/30	7	£2,004	10%

A small proportion of the properties are judged to involve greater short-term risk:

- M&S retail property at Yeovil (lease ends 31/03/27 – rental £505k pa; market rental value below 60% of passing rent and difficult to re-let)
- Wilko retail property at Yeovil (lease ends 28/04/25 – rental income £435k pa; market rental value below 50% of passing rent and difficult to re-let)
- Lyndon Place office in Birmingham (lease ends 31/10/2026; costly and difficult capital works required; high risk of void – rental income £196k pa)
- NCP (car park) in Bournemouth (tenant defaulted on lease; 12 month rolling agreement, ongoing risk, £200k pa income)

Risk mitigation:

For new tenancies undertake:

- Credit rating checks on tenant
- Analysis of a tenant’ s financial health, business operations, and future performance
- Consider asking for a deposit from the tenant

For overall portfolio tenancies:

- Establish and maintain robust lease events calendar system and regular monitoring with

structured arrangements for action triggers.
- Undertake prudent and realistic annual budgeting for income and costs.
- Proactively manage tenant relationships and intended tenant activity with the objective to secure the highest proportion of lease renewals rather than lease ends and re-letting.
- Proactively market new lease opportunities in a timely manner to minimise letting void periods.
- Retain earmarked risk mitigation reserve for these investments.

Risk that the building condition requires Council expenditure

Risk explanation: Properties may need expenditure to remain attractive to the market or to comply with current or future legislative standards, such as meeting the new Energy Performance Certificate (EPC) standards.

Review of the investment for yield portfolio has not yet identified any unit with an EPC rating worse than E although the review has a small proportion of properties yet to confirm. There will be future management needed for this as the EPC requirements will be increased to the point where a required rating of 'B' or above has been proposed to be needed by 2030.

Total risk exposure: short term risk is already addressed in capital budgets. Modelling should be undertaken to assess this component of risk reserve levels for the medium/long term.

Risk mitigation:
- Dilapidations at lease end are mostly at the expense of the tenant.
- Formal review of all existing let units should identify limitations on tenant repair obligations such as schedule of condition.
- Develop and maintain a robust capital budget for landlord expenditure at every potential lease expiry having regard to potential shortfalls in tenant dilapidations and reinstatement, key risks around building services, and aspects of building upgrades considered optimum for medium term income performance and lettability.
- Ensure management of the dilapidations processes are delivered in line with best practice to minimise cost impact to Council.

Risk that the portfolio is overexposed to certain property sectors and/or geographical locations

Risk explanation: There is more risk in owning a property portfolio where there is limited diversification in terms of geographic location and / or tenancy/property sector invested in.

Likelihood: The commercial property portfolio is diversified in terms of property sector and geographic location. This diversification reduces the risks of exposure to a single asset, tenant, or sector failure.

The portfolio at first glance may appear overweight in retail, but this is mitigated by the mix of high street, out of town, and retail warehouse properties. These are distinct sub-sectors performing quite differently.

Most substantial commercial property investors aim to achieve some portfolio churn in the medium term, selling properties when they offer the peak opportunity to realise capital growth or evolve the balance of the portfolio to respond to future or past changes in sector performance.

However the potential to pro-actively manage the portfolio appears severely limited by the terms of Prudential Code. The meaning of clauses in the Code referring to rebalancing and improvements may be clarified when the policy has been in use for some years.

Risk mitigation:
Whenever the highest-level strategy for commercial investments is set or revised, assessment should be made as to whether to seek recommendations for any properties for disposal due to issues of portfolio balance.

Risk that the Council may not receive the value invested if it sells

Risk explanation: property values can go up and down and there is the risk that the council can make a loss on the sale. Values are prone to fluctuation, for a range of reasons. These include economic shifts, changes in strategic investor requirements, financial market shifts, sector relative pricing, changes in the locality, or asset specific risks, such as tenant failure.

Likelihood: There is an immediate post-acquisition loss of the costs of purchase – assumed to be typically 6.8% of purchase price for Stamp Duty Land Tax and advisory fees. Shorter lease properties, or those where the contracted rent is well above the market rent, tend to progressively reduce in capital value as the lease term reduces. The capital value should return to the best level following successful reletting. In the case of over-rented properties, the eventual value is expected to be below purchase price.

Total exposure: The unaudited value of the investments as at the end of March 2022 are £264m. As compared to the total investment made (£289m) this is a decrease in value of £25m (9%), which is in part expected as initial costs include sunk costs such as taxes and fees above the purchase price. A new valuation will be undertaken to produce the 2022/23 Statement of Accounts, and as at 31 March each year thereafter. Any gains and losses in valuation do not impact on the budget or useable reserves, instead being written off to the Revaluation Reserve and Capital Adjustment Account. Any future actual disposal net proceeds are treated as capital receipts, and it is proposed these will be prioritised to reduce the Capital Financing Requirement (borrowing). If the proceeds fall short of the CFR balance at the time the residual amount will remain to be funded through the annual revenue charge for debt repayment (MRP) or other capital receipts set aside for debt repayment.

Risk mitigation: The council will undertake proportionate due diligence including:

Market Testing – The general presumption should be that any sale of an investment property asset should be subject to an open market sale where reasonable steps have been taken to identify all interests in acquiring the asset subject to expert advice on how best to optimise the value of the sale. There may be situations of a possible "special purchaser" – such as the tenant or owner of neighbouring property – where the price cannot be tested by general marketing. In any such cases, prior approval to engage would be confirmed with the Investment for Yield Performance Review Board. Confirmation that the negotiated price is appropriate and in excess of normal market value will be confirmed by external valuation.

Valuation – When an assessment is being made of whether to sell, advice should be obtained from appropriate specialists on expected selling price as well as best approach to marketing. An external investment agency firm is most likely to be used for sales and they should provide appropriate formal advisory recommendations.

Pre-sales due diligence – prior to any marketing, good practice due diligence should be completed to include legal work on perfecting title; resolution of management matters and assembly of good records and completion of any appropriate data room. The aim is to enable the sales process to progress in the easiest way and be able to close out any intended transaction with the risk that is involved with delays or unknowns coming to light.

Risk that the Council may not receive cash quickly if it wants to sell

Risk explanation: commercial investment property is relatively illiquid. Key reasons are that disposal must involve the whole property interest, and it involves a process of individual marketing, negotiation, due diligence, and then legal transaction. This is demanding and slow compared with assets such as equities, bonds, or investment units. Values are prone to fluctuation, particularly due to changes in the locality, the general economic outlook, or asset specific risks, such as tenant failure. The market is impacted by changes in confidence. Sharp economic downturn may lead to a period of severely restricted buyer demand.

Likelihood: The market fundamentals for this asset class are a fixture which cannot be avoided, and part of the context for direct investment in property. Extreme market cycles are occasional but difficult to predict.

Total exposure: This depends on the high-level strategy. If the intention is a long term "hold" then this risk is in the background. The current Prudential Code means the council could not operate as a "trader" in investment property. If there is an intention to partly or fully divest from the property investment portfolio, this can be planned to be delivered when market conditions are helpful and in an orderly programme.

Risk mitigation:

- Long term cash management planning so that shorter term capital requirements do not need to be linked to property investment sales.
- Any divestment options for investment property should be considered with strategic advice as to the expected market conditions and values, and if implemented then the approach should allow a reasonable time-period for sales to be concluded.
- A high-level strategy for the property investment objectives needs to be formulated and periodically reviewed. This will set and re-set the intentions as to the extent of divestment, if any.
- The property investment team should review the legal package for each asset, manage the physical assets, and tenant relationships and records so that there is a general situation of readiness should there be a decision to sell. Presale packs prepared before any property is put on the market.

Potential risks arising from economic and legislative changes:

Unfavourable economic outlook

Risk explanation: Property financial performance is closely related to factors in the general economy. Including prevailing interest rates.

Likelihood: A significant proportion of the capital financing requirement is currently financed through internal borrowing (which reduces treasury investment risk) and through short term loans. The Council will need to replace short term loans and may need to externalise internal borrowing and is therefore exposed to the interest rates available when refinancing decisions are made. If the cost of borrowing increases this adversely impacts on net income available to fund services.

It is considered highly likely that interest rates will continue to rise for the next 1-2 years but then begin to fall. It is considered unlikely the rates will return to the historic lows seen on the past decade.

Total Exposure: The estimated CFR on 1 April 2023 is £264m. 1% volatility in interest costs for a full year would be £2.64m.

Risk Mitigation:

- Prudent estimates of anticipated interest costs used for the budget.
- Taking advice from Arlingclose on a prudent treasury management approach to support the Council's overall approach to investment and borrowing.
- Holding adequate reserves to withstand adverse budget variances.
- Applying MRP to reduce debt and therefore the amounts required to be refinanced.

Risk of further changes to legislation

Risk explanation: Government and CIPFA have undertaken significant changes to legislation and guidance over recent years regarding investments made for yield with the impact of restricting activity by councils in this area. There could be further legislation in the future.

Likelihood: Government has already consulted in changes that would require councils to provide Minimum Revenue Provision (MRP) on lending to third party organisations (see Annex 13C).

There is also a possibility that enforcement will result in investment for yield investments having to be held via a company structure rather than directly by councils.

Risk mitigation: to keep aware of possible legislative changes and respond to any further consultations.

ANNEX 13C: RELEVANT REGULATORY FRAMEWORK

Borrowing from the Public Works Loan Board (PWLB)

On 26th November 2020 HM Treasury introduced new lending terms for the PWLB. Guidance issued at that time was further clarified and updated on 21st August 2021.

The changes mean that local authorities will be unable to borrow from the PWLB to finance any expenditure in their capital budgets if they are planning to acquire new investment assets bought primarily for yield in any of the following three financial years.

Local authorities cannot use the receipts from selling investments made for yield to acquire new investment for yield assets. Local authorities can only use the receipts from selling these investments to finance other capital expenditure in service delivery, regeneration, housing, and preventative action, or to repay capital debt.

HM Treasury advise that investment assets bought primarily for yield would usually have one or more of the following characteristics:

- buying land or existing buildings to let out at market rate,
- buying land or buildings which were previously operated on a commercial basis which is then continued by the local authority without any additional investment or modification,
- buying land or existing buildings other than housing which generate income and are intended to be held indefinitely, rather than until the achievement of some meaningful trigger such as the completion of land assembly, and
- buying a speculative investment asset (including both financial and non-financial assets) that generates yield without a direct policy purpose.

This does not prevent local authorities from borrowing for projects that are primarily for other purposes, but which also happen to generate a financial yield.

Local authorities are also able to borrow from the PWLB to finance capital expenditure to maintain existing commercial investments or to fund capital investment needed to increase their value prior to disposal.

Any investment bought primarily for yield which was acquired after 26th November 2020 results in the local authority not being able to use the PWLB to refinance this transaction at any point in the future. Such investments acquired, or contractually committed, prior to 26 November 2020 will not affect the local authority's access to the PWLB.

As a condition of accessing the PWLB, Local Authorities must submit a high-level description of their capital spending and financing plans for the following three years, including their expected use of the PWLB. The S151 Officer needs to confirm that there is no intention to buy investment assets primarily for yield at any point in the next three years. This assessment is based on their professional interpretation of guidance issued.

CIPFA Prudential Code

The Local Government Act 2003 requires Local Authorities to "have regard to" the Chartered Institute of Public Finance and Accountancy (CIPFA) Codes of Practice and they must explain their rationale and get Council approval if they choose to disregard this guidance.

A revised Prudential Code was published in December 2021. Some of the requirements of the revised Code applied with immediate effect following publication; including the stipulation that an authority must no longer borrow to invest primarily for a financial return.

Other changes could be delayed until 2023/24 including the requirement to annually review investments held primarily for yield with a view to divesting where appropriate. Relevant extracts from the Code are given below.

Authorities with existing commercial investments (including property) are not required by this Code to sell these investments.

Such authorities may carry out prudent active management and rebalancing of their portfolios, including repair, renewal and updating of the properties.

However, authorities that have an expected need to borrow should review options for exiting their financial investments for commercial purposes and summarise the review in their annual treasury management or investment strategies.

The reviews should evaluate whether to meet expected borrowing needs by taking new borrowing or by repaying investments, based on a financial appraisal that takes account of financial implications and risk reduction benefits.

CIPFA revised Treasury Management Code (2021) and DLUHC Statutory Guidance on Local Authority Investment Activity (2018)

These essentially contain the same statutory guidance with respect to non- treasury management investments. They contain requirements for councils to:

- Prepare an annual Investment Strategy which must be approved before the start of the forthcoming financial year by full Council.
- Ensure the strategy is publicly available on a local authority's website.
- Disclose the contribution that all non-treasury management investments make towards the service delivery objectives and/or place making role of that local authority.
- Include quantitative indicators within the strategy, that allow Councillors and the public to assess a local authority's total risk exposure because of its investment decisions. This should include how investments are funded and the rate of return.

The guidance requires that councils should consider the long-standing treasury management principles of security, liquidity, and yield (in that exact order) when considering non-treasury investments. These principles are briefly explained below:

- Security - Safeguard the value of, and expected returns from, the council's investment.
- Liquidity - Ensure the investment can be quickly divested to meet the council's cash flow requirements.
- Yield (the net return achieved from the investment) - Investment return is the final objective and should be considered after the security and liquidity requirements have been satisfied.

Minimum Revenue Provision (MRP)

MRP is the minimum amount which a council must charge to its revenue budget each year, to set aside a provision for repaying external borrowing (loans) and/or internal borrowing. It is the statutory duty for each authority to determine each year an amount of MRP that it considers to be prudent in accordance with section 21(1A) of the Local Government Act 2003 (revised 2018).

Recent consultations by DLUHC (Department for Levelling Up, Housing and Communities) indicate they would like to reform the guidance around MRP and, specifically with reference to non-treasury management investments, legislate councils to provide MRP on a debt which relates to investment for yield assets or capital loans made for yield or for service purposes. The legislation has been delayed and has not yet been introduced. However, the Council’ s MRP policy will include the approach recommended by the S151 Officer as a prudent provision notwithstanding future guidance.

Legislation regarding the sale of property investments

Compliance with Section 123 of the Local Government Act 1972 will be required which states that "except with the consent of the Secretary of State, a council shall not dispose of land under this section, otherwise than by way of a short tenancy, for a consideration less than the best that can reasonably be obtained".

Energy Performance Certificates (EPC)

Energy Performance Certificates (EPCs) set out how energy-efficient a property is from A (most efficient) to G (least efficient). They also show the potential level of emissions and associated costs of improving the rating for that property. Owners must obtain an EPC whenever a property is built, sold, or rented.

From April 2023, it will be a legal requirement for all commercially rented properties to have an EPC (Energy Performance Certificate) rating of at least E. This is currently a legal requirement for commercial properties before they can receive a new or renewal lease, but from next year this requirement will be extended to both new and existing commercial leases too.

The responsibility for obtaining an EPC is with the landlord of a property except where a lease is in place with an original term more than 99 years.

SOMERSET
County Council

2023/24 Non-Treasury Management Investment Strategy

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Lead Member, Division, and Local Member: All

1. Summary / Background

1.1. This is the 2023/24 Non-Treasury Management Investment Strategy for the new Somerset Council and meets the various legislative and guidance requirements as set out in section Appendix C of this report.

1.2. This investment strategy is required to be considered by the Council as part of the 2023/24 budget setting process.

1.3. It specifically covers service investments (i.e. loans provided to third parties which help deliver service objectives and priorities) and investments made primarily for yield – predominantly commercial property holdings. The latter are properties which are held purely for the rental income they generate and/or anticipated growth in their capital value. They are not used directly to deliver services, although the income that is generated is used to provide additional funding for services provided by the Council.

2. Recommendations

2.1. Audit Committee is being asked to review the 2023/24 Non-Treasury Investment Strategy and to recommend its approval to the Executive and Full Council.

3. Reasons for recommendations

3.1. The Council is required to agree a non-treasury investment strategy in line with the Prudential Code, and to consider this alongside the budget.

4. Other options considered

4.1. The new Council will hold service investments and investments for yield through the transfer on 1 April 2023 of such investments from the predecessor councils in Somerset. The requirement for the strategy is driven by regulation and good practice.

Options specific to non-treasury investment activity are considered within the main body of this report.

5. Links to County Vision, Business Plan and Medium-Term Financial Strategy

5.1. The investments held will present ongoing opportunities and risks to be managed and provide a significant gross income which is reflected in the financial strategy and budget estimates. Financing of these investments is considered within this report and as part of the capital and treasury management strategy.

6. Consultations and co-production

6.1. Consultation with relevant officers across the predecessor councils undertaken as part of the Local Government Reorganisation Implementation Programme.

7. Financial and Risk Implications

7.1. Section 16 of this report details the financial implications of holding these investments whilst Appendix B gives an analysis of the potential risks.

8. Legal and HR Implications

8.1. Appendix C of this report gives considerable detail on the legal framework within which the council will need to manage and report on these investments.

8.2. Section 15 sets out the management of these investments in terms of officer capacity and skills. This is still very much a work in progress, as the detailed officer structure for the new authority is not yet finalised.

9. Other implications

9.1. Equalities implications

9.1.1. None.

9.2. Any other relevant implications

9.2.1. None.

10. Scrutiny comments / recommendations

10.1. The proposed strategy will be considered by the Audit Committee on 2February 2023, with any comments to be incorporated for consideration of the Executive and Full Council.

11. Background

11.1. The 2023/24 Non-Treasury Management Investment Strategy for the new Somerset Council is required to be considered by Somerset County Council as part of the 2023/24 budget setting process. This is a complex and highly regulated area of activity, and this strategy has been written to meet the relevant regulatory framework as set out in Appendix C of this report.

11.2. Councils invest money for three broad purposes:

1) Because it has surplus cash arising from its day-to-day activities or cash that it holds pending its spending plans (known as treasury management investments).

2) To support local public services by lending to other organisations (known as service-based investments).

3) To earn investment income (known as investments made primarily for yield or commercial investments).

11.3. This investment strategy focuses on the second and third of these investment categories and together they are termed non-treasury management investments. The first category is considered in the 2023/24 Treasury Management Strategy. Whilst service investments and investments primarily for yield are entered into and managed outside of normal treasury management activities, the Treasury Management Strategy comes into play in their financing.

11.4. The objectives of this Non-Treasury Management Investment Strategy are to provide:

1) The proposed Strategic Objectives for 2023/24.

2) A high-level overview of the different types of non-treasury investments that will be held by Somerset Council on 1st April 2023.

3) The governance and reporting arrangements for these investments.

4) Management of the investments and the capacity, skills, and knowledge available to the Council.

5) The Annual Review of financial performance, as required under the revised Prudential Code, for 2023/24 of the net cost/return to the General Fund revenue budget of holding the investments for yield.:

6) An explanation of the relevant regulatory framework that needs to be considered when holding, managing, and divesting these investments.

7) An analysis of the associated risks and management's proposed mitigations including indicators which allow Elected Members and the public to assess the level of risk involved.

11.5. Proposed 2023/24 Strategic Objectives

Strategic Objective 1: Ensure the Council has flexibility and choice in obtaining loan finance.

Policy commitments and detailed objectives:

- Ensure the Council meets the criteria for accessing the Public Works Loan Board (PWLB) by not acquiring any new investments that fall within the definition "investments primarily for yield".

Strategic Objective 2: Ensure the investments for yield continue to contribute to the Council's overall financial health.

Policy commitments and detailed objectives:

- Retain the current investments made primarily for yield that will be vested to Somerset Council from the predecessor councils on 1st April 2023 for the immediate future.

- Ensure effective arrangements are maintained to collect all income due in a timely manner, and actively manage tenancy and lease arrangements to minimise losses through voids and/or non-collection of rents and service charges.

- Undertake regular modelling of the net return being achieved and forecast from holding these investments for the portfolio as a whole and for individual properties and from both the shorter and the longer-term viewpoint.

- Establish objectives, aims and expectations around the contribution being targeted from investments for yield.

- Maintain a proactive knowledge of the state of the UK commercial property market.

- Undertake regular reviews of relevant risks and mitigation options.

- Review opportunities for new permitted investment in existing investments to maximise the net return and/or improve the asset value (within acceptable risks).

- Review opportunities for selling the investments to maximise the overall net return, or to minimise future risks (such as reducing the Council's exposure in a particular market sector or geographic location), or to generate capital receipts.

- Review options available to the Council to finance the remaining indebtedness that has arisen from purchasing these investments to maximise the net return or to minimise future risks.

- Obtain relevant expert advice, when needed, to achieve these objectives.

Strategic Objective 3: Ensure commercial property investments are attractive in the market

Policy commitments and detailed objectives:

- Develop a Property Investment Strategy to ensure:
    - Properties remain attractive to tenants for letting and, at least, maintain their investment value.
    - Properties are fit for purpose, safe, and compliant with relevant legislative requirements.

- Review the costs of achieving a) and b) above with the potential return obtainable and the impact on other capital financing needs.

12. Investments Primarily for Yield

Background

12.1. The four predecessor district councils in Somerset all established programmes of investing for the primary purpose of making a yield. Most of the activity focused on acquiring commercial property. Many other councils across the country have also pursued this strategy with levels of local authority investment increasing more sharply in recent years across the sector.

12.2. The net returns make a significant contribution to the funding of the four councils' General Fund revenue budgets because the additional income generated exceeded the returns the councils were able to get with their cash investments and more than covered the costs of any short-term and longer-term borrowing undertaken to fund the capital acquisition costs.

12.3. The primary objective for all four councils was to generate new income to enable them to continue providing essential council services to their communities at a time of declining financial support from central government, and where risk and uncertainty of funding remains high (notably, Government grants and business rates). This was achieved.

12.4. The four councils viewed these acquisitions as long-term investments that would be proactively managed by having the flexibility to respond fluidly to opportunities and changes in the economy, the market, and differing performance across asset classes. The ability to sell properties to reinvest is a common portfolio investment tool in the private sector which helps achieve higher net returns whilst also mitigating risk.

12.5. However, since the strategies were implemented, there have been several changes to the regulatory and economic background that have significantly impacted on this investment activity (see Appendix C for the detail):

a) Changes were made to the PWLB (Public Works Loan Board) terms of lending effectively making it inaccessible for councils who continue acquiring investments made primarily for yield.

b) Changes made to the Prudential Code also prohibited acquiring investments primarily for yield with councils needing to pay "due regard to" the guidance as required by legislation.

c) Other changes made to the regulatory framework now prohibit councils using the sales proceeds from selling these assets to fund new investments for yield. This means that the approach private property fund managers undertake in selling and repurposing the proceeds to acquire better performing and/or less risky assets cannot now be undertaken by councils.

d) Unfavourable and very rapid changes to the economic situation, particularly the rise in interest rates during the 2022/23 financial year and the risk of a recession, are putting pressure on the investments achieving a net rate of return in the short and medium term and potentially increase the risks involved in holding these investments.

12.6. Given that PWLB loan finance represents a relatively cheap and easy-to-access source of long-term borrowing, as compared to other often more complex sources of loan finance, it is being recommended in this strategy that Somerset Council ensures it has access to the PWLB if needed and therefore does not undertake any new acquisitions that fall within the definition of "investments primarily for yield".

12.7. The Director of Finance and Governance can confirm that the proposed Capital Budget for Somerset Council for the period 2023/24 to 2027/28 does not contain any budget for acquiring investments primarily for yield.

12.8. The portfolio of investments made primarily for yield is therefore now complete. The focus for Somerset Council will be on proactive management of the investments and associated risks within the regulatory framework as set in the proposed Strategic Objectives shown in paragraph 11.5 of this report.

Commercial Property Acquisitions and their financing

12.9. The period over which these investments were acquired is shown below. No further investments meeting the definition "investments primarily for yield" were acquired after December 2021 when the revised Prudential Code came into effect:

- Mendip District Council: October 2017 to November 2019
- Sedgemoor District Council: December 2018 to December 2020
- Somerset West & Taunton District Council: August 2020 to December 2021
- South Somerset District Council: November 2017 to December 2021.

Table one: Acquisition costs and financing (£000s)

Figures are in £000s	Mendip	Sedgemoor	Somerset West & Taunton	South Somerset	Total
Investment made	50,401	46,500	98,965	93,224	289,091
Funded by:					
Capital Receipts				4,000	4,000
Revenue resources			3,520		3,520
Long term borrowing	50,401				50,401
Short/internal borrowing		46,500	95,445	89,224	231,170

12.10. The councils financed their investment acquisitions through a variety of ways. Most of the funding however was by means of borrowing. Mendip District Council financed their investments through taking out several long-term loans whilst the other three predecessor district councils financed their investments through a mixture of revenue funds, capital receipts, internal borrowing, and shorter-term external loans.

Overview of the commercial property portfolio

12.11. The new Somerset Council inherits a diversified property portfolio, with a balanced spread between asset classes and geographical locations which will help mitigate the potential risk of holding assets all in one sector and/or location.

12.12. The following paragraphs and charts aim to illustrate key aspects of the investments held.

Chart One: Commercial property investments key metrics

Capital investment made £289m

Individual investment value from £0.7m to £22m

48 properties 36 out of Somerset	17 multi let 31 single let	96 tenants Currently 6 voids
Average income per tenant £209k	Gross average yield 7.5%	Average WAULT 6.45 years

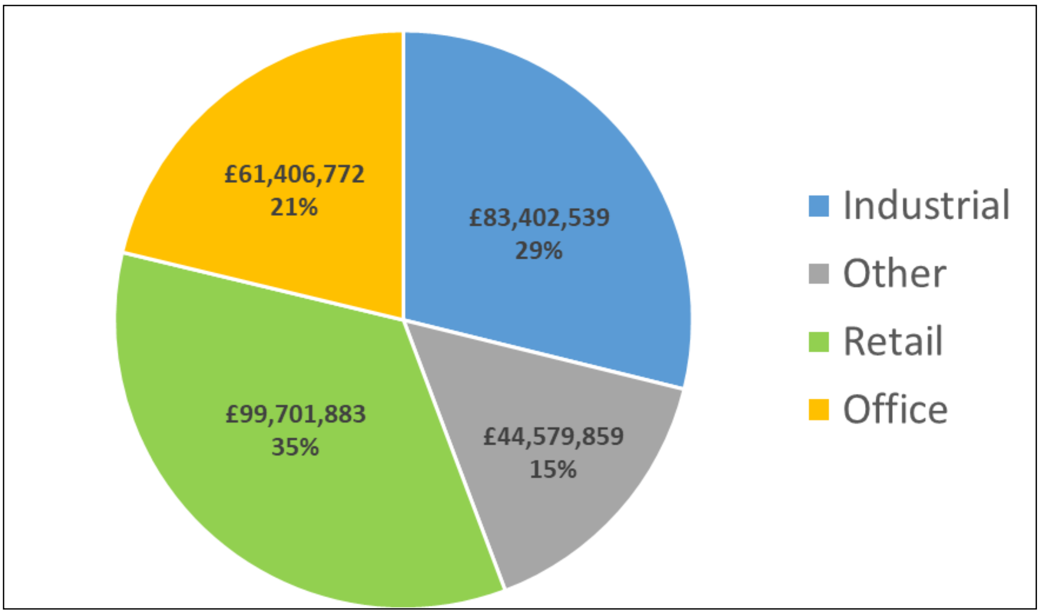
Gross rental income (2023/24) £20m

Direct holding costs (excluding officer time & financing charges) £0.8m

WAULT = weighted average unexpired lease term
Gross Yield = Contracted income return percentage on purchase price

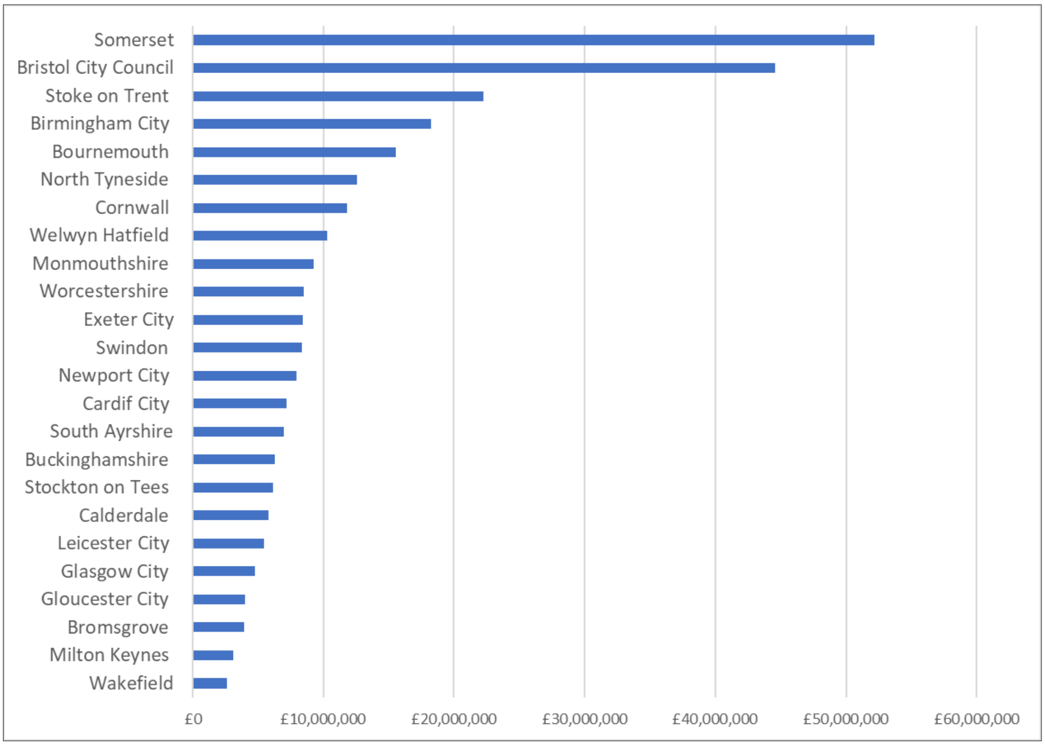
12.13. **Property sectors:** The portfolio is weighted towards retail and industrial asset classes. 35% of the investment has been made in the retail property sector followed by industrial (29%), office (21%), and the other property sector (21%). investments made in the latter include: a healthcare centre, a gym, and an NCP car park. Of the retail property, 25% can be regarded as high street / town centre retail.

Chart Two: Investments made per property sector (asset classes)



12.14. **Location of the investments:** 75% of the properties held are located out of Somerset Council's area. By value, £237m (or 82%) of the total investment that has been made is outside of the new council boundary. Chart Three shows the value of investment made across the United Kingdom.

Chart Three: Property investment made per local authority area



12.15. **Average size of investments:** The average acquisition price was £6.023m with 48% of the £289m invested being on properties acquired within the £5m to £10m range. The largest acquisition of £22m was made for an industrial property in Stoke-on-Trent.

Chart Four: showing size of investments made (numbers = no of properties)

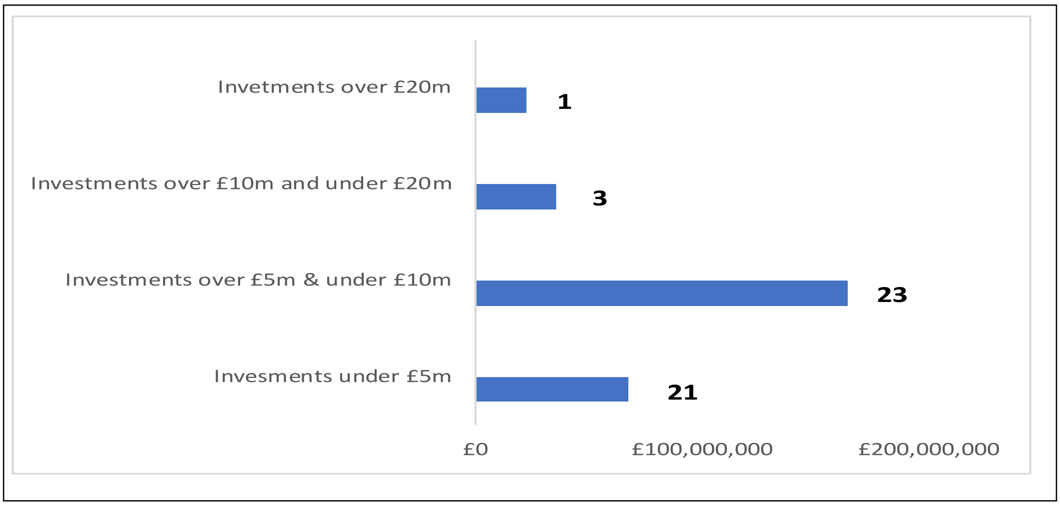
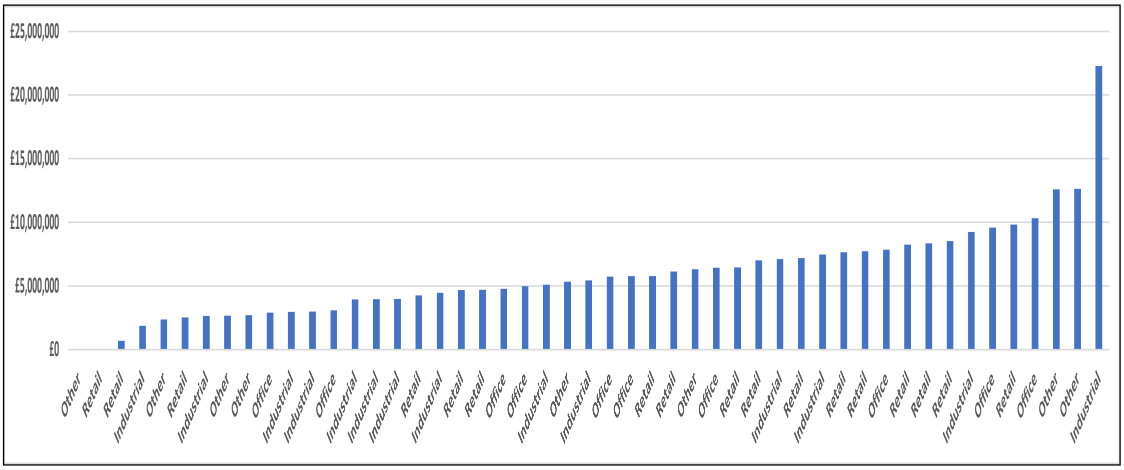
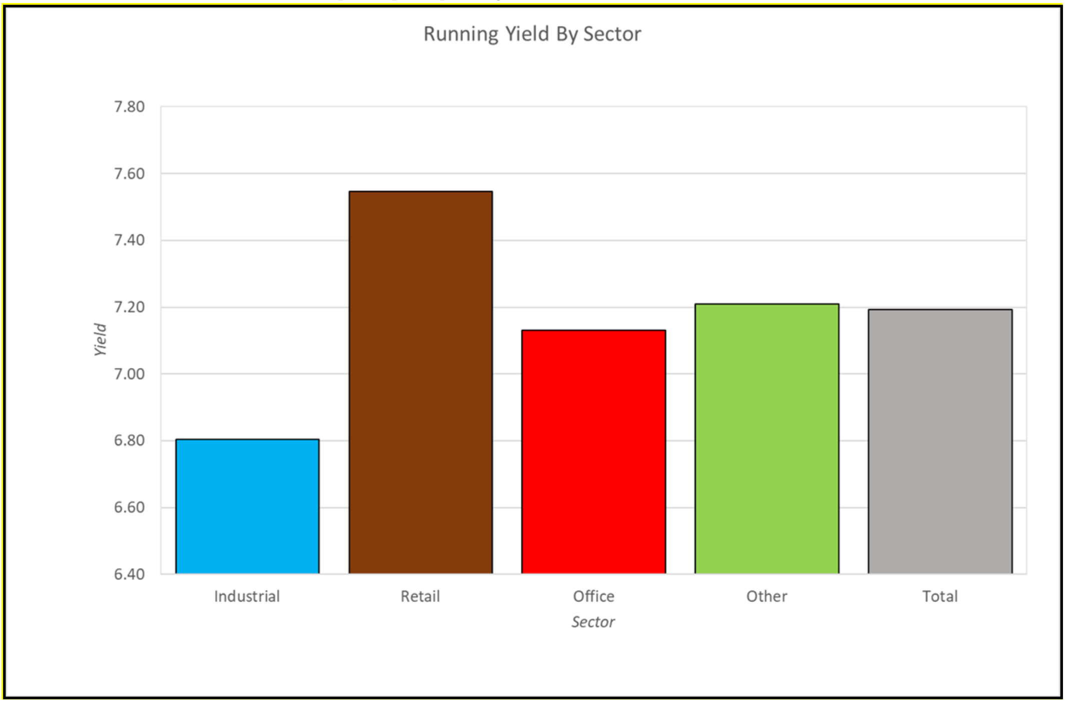


Chart Five: Acquisition cost per property



12.16. **Gross yield:** (which is the gross current income divided by the investment purchase price) by property sector shows the initial return the contracted rents provide split by district council and by investment sector.

Chart Six: Gross Yield % per property sector



12.17. **Investment value:** The unaudited value of the commercial property investments as at the end of March 2022 is £264m. As compared to the total investment made (£289m) this is a decrease in value of £25m (9%) but one-off costs of purchase (fees and SDLT) account for most of this difference. A new valuation will be undertaken to produce the 2022/23 Statement of Accounts. It should be noted that £15m of the indebtedness arising from purchasing these assets has already been paid by the predecessor councils through Minimum Revenue Provision (MRP) payments from their revenue budgets.

12.18. **Security, liquidity, and yield:** The principles of security, liquidity, and yield must be considered when making any investment. When considering treasury management investments, security is the highest priority, followed by liquidity, and yield is a low priority. However, the objectives for investing primarily for yield (i.e. to make a return to support the funding of core council services) has meant that such investments have not always prioritised security and liquidity as highly as treasury investments do.

12.19. Commercial property is not a liquid investment, such as a bank account where one can withdraw needed cash immediately. They can take significant time, and cost, to sell and are only divisible by the individual ownership components. A reasonable rule of thumb is to allow up to 6 months to dispose of an investment property.

12.20. **SSDC Opium Power Ltd (SSDC OPL):** As part of its commercial strategy, the predecessor South Somerset District Council, invested £42m through a joint venture company, SSDC OPL, in a design, build, finance and operation of battery energy storage systems (BESS) at Taunton, Somerset (SSDC OPL) and at Fareham, Hampshire (FERL 1 and 2).

12.21. The current structure of the JV comprises a parent company, SSDC Opium Power Ltd (SSDC OPL) and two subsidiary companies, Fareham Energy Reserve Ltd (FERL 1) and Fareham Energy Reserve 2 Ltd (FERL 2). There are 100 shares in SSDC OPL: the Council holds 50 and OPL holds 50. All the shares in FERL 1 and FERL 2 are held by SSDC OPL.

12.22. The returns from these investments come by way of interest on the capital lent by SSDC to the joint venture company, and dividends from the profits of the company. In addition, the loan repayments are used to fund the capital budget thus reducing the Council' s overall borrowing needs.

Table Two: loans made to SSDC Opium Power Ltd and subsidiaries

Amount Lent	Loan Date	Interest rate	Loan Period	Maturity date
9,840,000	17/05/2018	5.00%	8.25 yrs	31/07/2026
1,284,000	29/03/2019	5.00%	7.35 yrs	31/07/2026
2,033,055	15/08/2019	7.50%	7 yrs	31/07/2026
13,157,055	Total Loan to SSDC Opium Power Ltd			
18,690,560	20/10/2020	4.00%	25 yrs	01/01/2047
18,690,000	Total loan to FERL 1			
10,318,980	26/05/2021	4.00%	25 yrs	01/04/2048
10,630,877	Total loan to FERL 2			
42,477,932	**Total loan to SSDC OPL and subsidiaries**			

12.23. The loan balance at the end of March 2023 is forecast to be £39m. £3m of the £3.7m scheduled loan repayment for 2022/23 has already been paid (as at the time of writing this report).

12.24. As these projects needed to be constructed prior to any trading, there was an initial period of investment without immediate return. Taunton was completed in 2020, FERL 1 was completed in February 2022, and FERL 2 reached completion in June 2022. The project on this last facility is completing all its technical tests and will shortly start trading.

12.25. SSDC Opium Power Ltd started to generate a profitable trading position during 2020/21. Under the provisions of the Shareholders' Agreement for SSDC OPL any dividend payment requires express consent from the Council. For Taunton, there can be no dividend until the loans are repaid in full. Profits made to date have been used to accelerate the repayment of the loans provided by the Council. The dividend share is 50:50 between the Council and the other shareholder (OPL).

12.26. FERL 1 began to trade during 2022. Loan repayments are being made in accordance with the minimum amounts set out in the loan agreement, leaving a surplus in the company. Any profits are shared 65:35 in favour of the Council. As at the time of writing this report, the predecessor council is considering its position on whether to take a dividend or require the profit to service the earlier repayment of the loan debt outstanding.

12.27. FERL 2 has similar arrangements to FERL 1 other than the profit shares being 70:30 in favour of the Council.

12.28. **Security, Liquidity, and Yield**: The arrangements involve substantially more complexity than the property investments with the company structure, separate accounting and governance, and the need for the Council to appoint Directors to the Board. This investment sector is very specialised requiring niche advisory providers and is focussed on an emerging market which should be viewed as riskier.

12.29. However, the loan principal and interest are being paid in line with the agreed loan schedule. The current income returns to the company are well above the forecasts made when the lending was approved, but this trading information cannot be disclosed in a public report. The investment, like the commercial property portfolio, is not particularly liquid.

13. Investments made for service purposes

13.1. The predecessor councils have lent money to businesses, charities, housing associations, and other public bodies to support their service objectives. The table below shows the service investments (which are in the form of loans) the new Council will inherit on 1 April 2023 (unless any are redeemed early).

Table Three: Service Investments held by Somerset Council

Sector	Total Loan amount £	Financial Year(s) given	Total Balance as at 1/04/23 £	Length of loan period(s) remaining	Interest rate(s)
Registered Housing Association	117,810	1971/72	44,500	10 years	2.84%
Registered Society	1,684,900	2014/15 2015/16 2021/22	1,020,124	7 years	Various 3.49% - 4.89%
Charities	3,566,646	2017/18 2019/20	3,341,363	2- 26 years	Various 2.57% - 4.5%
Local Business	500,000	2018/19	400,223	14 years	3.75%
Council subsidiary	419,000	2015/16 2018/19 2019/20 2020/21	1,320,661	22 -27 years	Various 1.11% - 5.04%
College	4,500,000	2019/20	4,176,577	17 years	4.50%
Local Business	190,000	2015/16	88,890	13 years	2.76%
Schools	271,424	various	TBC	various	0%
	11,249,780		**10,392,338**		

13.2. Members may also wish to note that the Councils currently hold inter-authority service loans, for example in respect of loans provided by the district councils to SCC towards funding capital investment in the Somerset Waste Partnership. When the councils merge to form the new unitary authority on 1 April these loans will be cancelled, leaving the ongoing capital financing requirement to be financed through future treasury management.

13.3. **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. However, the total risk exposure to service investments is currently £10.4m, which is not considered to be disproportionate to the overall size of Somerset Council.

13.4. Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figure for any loans in the statement of accounts at the end of 2023-24 will be shown net of this loss allowance. However, up to this point in time no loss or impairment of these loans has had to be made.

13.5. **Liquidity**: These investments are not liquid as the repayments are made in line with agreed loan agreements. Table Three shows that most of the outstanding current debt will not be fully repaid before fifteen years.

13.6. **Yield**: In view of the public service objective, the yield obtained from the service investment has not always been the primary consideration.

Policy for granting service loans

13.7. Whilst given the public service objective, the Council is willing to take more risk than with conventional treasury investments; any decisions on granting such loans will be made on the basis that repayment to the Council remains a firm, secure, and realistic commitment from the applicant.

13.8. The yield obtained will not always be a primary consideration, but the Council will normally seek to at least cover its own financing costs in funding the loan and will pay due regard to market rates.

13.9. The Council may also from time to time make Soft Loans (loans charged at interest rates at less than market value). Before such loans are undertaken, the implied subsidy will be clearly identified and quantified as part of the decision-making process.

13.10. All loan requests must be set out in a Business Case from the sponsoring service demonstrating how the loan will deliver service outcomes.

13.11. Due diligence will be undertaken by carrying out a proportionate review of the credit risk of the applicant, a review of its published financial statements, and the Business Case detailing how the loan will be used.

13.12. Where deemed necessary (for example where a large loan request has been made) the Council will seek a legal charge on the underlying assets of the applicant to mitigate against the risk of the applicant defaulting on the loan.

13.13. All service investment requests will be considered in the context of the impact on the cumulative total of all such loans made by the Council and any implications for the its shorter and longer-term cash flow requirements.

13.14. Total exposure for service loans will be contained within the prudent limit set within the Treasury Management Strategy.

14. Governance and reporting arrangements

14.1. In line with legislative requirements this Investment Strategy will be prepared annually and will be approved by full Council as part of the wider budget setting process.

14.2. The Audit Committee is responsible for reviewing this Investment Strategy, recommending the strategy to Council for approval. It will receive a Mid-year Review Report and an Outturn report which are also reported to Council.

14.3. Monitoring of the budgets associated with these investments (for example, the rental income received compared to budget) will be included in the quarterly corporate budget monitoring report to Executive.

14.4. A review of the financial performance in terms of the net return being achived will be undertaken and reported quarterly in a separate report to Executive.

14.5. Significant information about the investments is required to be disclosed annually in the Statement of Accounts. This is subject to external audit.

14.6. Further appropriate governance arrangements will be put in place as part of the work on the constitution and democratic arrangements.

Officer delegation:

14.7. The Executive Director of Resources & Corporate Services (s151 Officer) has the overall responsibility for delivering the agreed Non-Treasury Management Investment Strategy and the 2023/24 Strategic Objectives.

14.8. Appropriate delegations will be made to the Service Director - Strategic Asset Management and the Service Director – Finance & Procurement to support delivery.

15. Management of the investments, capacity, and skills

15.1. Property Portfolio Management: In terms of day-to-day resource requirements and officer focus, the commercial property portfolio and SSDC OPL will need more proactive management than the other non-treasury management investments.

15.2. The four predecessor districts approached portfolio management in a broadly similar way and managed single-let properties in-house with multi-lets managed via external agents with service charge administration costs recovered from tenants. Managing multi-tenanted property is more complex and time consuming that managing single let property.

15.3. Investment property asset management is an area of experience not held by some local authority property specialists. Currently, there are only two investment specialists employed within the predecessor councils.

15.4. At the time of publication of this report, Somerset Council is very much in a transitional phase, with appointments to the tier 3 structure unlikely to be in place in January 2023 and with a clear position from the Chief Executive that the development of detailed structures beneath tier 3 will not be taken forward until service directors are in position.

15.5. It is not possible therefore to give details of the arrangements that will be available to manage the commercial property portfolio apart from the fact that it will fall within the service area for the Service Director - Strategic Asset Management. Sufficient budget for the staffing establishment, advisers and the range of consultancy costs must be retained so that good practice management delivery can be achieved as that is critical to income performance and protecting value.

15.6. The objectives for the management of the commercial property investments will be to:

a) Ensure that the Council has a fully resourced, proactive, and professional management in the handling of its commercial property to optimise the value of the investments and rental income over time. The evaluation of the mix of in house and external resources is in hand but not yet completed.

b) Modernise asset records and systems to ensure the efficient management and recording of property/tenant data and lease renewal dates to aid the timely collection of rents and service charges.

c) Ensure Property Finance management is a focussed activity with sufficient resources to deliver ongoing financial due diligence, monitoring and reporting, and to support decision making. This is a critical resource requirement due to volume and value of financial transactions involved with the portfolio, and the specialised requirements.

d) Develop a unified policy on the approval and giving of discounts and incentives, deposit management, debt collection, and write-offs.

e) Ensure effective budgetary control of the Council's financial position through completion of realistic prudent budget estimates and ongoing review of income, debt levels and void rates.

f) Undertake yearly valuation of investment assets.

g) Undertake effective rent reviews, re-gearing of leases where appropriate, or remarketing of lease opportunities in a timely and market-focused manner.

h) Undertake tenant vetting prior to a new lease being granted to minimise credit and default risk.

i) Ensure tenants fulfil their repair and maintenance obligations of their lease including dilapidation on termination.

15.7. **Skills and knowledge available:** The Executive Directorate of Resources & Corporate Services will include officers who are qualified chartered accountants and chartered surveyors.

15.8. Ongoing treasury management advice and taxation advice will be provided by specialist advisers to the Council.

15.9. The Council will use valuation experts to value Property, Plant and Equipment and Investment Properties. Expert advice will also be procured to value SSDC Opium Power Ltd battery storage assets which require very specialised advisers.

15.10. The portfolio management approach is being reviewed. Options will be presented with recommendations. Any internal appointments and external advisers can then be appointed and transition from existing arrangements and contracts completed.

15.11. Other specific advice will be procured as and when needed. There will be significant property legal resource requirements. The resourcing approach will need to be agreed and put in place.

15.12. The Council will ensure that appropriate training and learning is given to all officers involved in this area of work.

15.13. It is important that elected members understand the decisions they will be asked to make relating to these investments and indeed this is a regulatory requirement in CIPFA Prudential and Treasury Management Codes.

15.14. To ensure that members have the knowledge and skills required to support them in their decision-making role, a series of training events will be developed during 2023/24 which will cover the relevant knowledge areas.

16. Financial Performance of the investments made primarily for yield

16.1. Financial modelling has been undertaken to determine the net impact on the Council's General Fund revenue budget of holding these investments after considering the financing costs that can be reasonably associated with the borrowing undertaken to fund their acquisition.

16.2. Borrowing is of three types:

- Internal borrowing – using available cash to purchase the investment instead of putting the cash into the bank or other savings accounts. The use of this cash is temporary as it needs ultimately to be used for its intended budgeted purpose.
- Short term borrowing, generally a year or less, from external institutions.
- Longer term borrowing from external institutions, for example the Public Works Loan Board (PWLB) with lending available for up to 50 years.

16.3. Other longer term financing options may be available such as leases.

16.4. Local government does not borrow specifically for a particular capital purchase of an investment unlike, say, a homeowner who obtains a mortgage to fund a particular property.

16.5. This makes it difficult to be precise about what sort of borrowing has been undertaken in respect of financing these investments as compared to the rest of the capital programme. Mendip District Council obtained longer-term loan finance whilst the other three councils used internal borrowing and short-term loans in different proportions which changed over time.

16.6. A pragmatic view has been taken by calculating the proportion of the Capital Financing Requirement (CFR) (the amount of indebtedness held by the predecessor councils) arising from these investments as a percentage of the overall indebtedness incurred by funding their capital budgets. This amount has then been reduced to take into account the MRP (Minimum Revenue Provision) payments made by the councils since the investments were acquired (by £15m) which has reduced the indebtedness held.

16.7. This CFR position is used as the starting point to analyse whether the gross rental income is sufficient to cover the 2023/24 and future years' financing charges arising from this inherited indebtedness position. Current and forecast interest rates are used as well as the new Council's proposed MRP Policy.

Other key assumptions made:

16.8. The worst-case position for borrowing: that is the Council takes out loan finance from the PWLB rather than uses its own cash or short-term borrowing - both of which would have lower interest rate implications than PWLB borrowing. In practice the Council may not be able to use PWLB for a significant proportion of refinancing and will instead prioritise other options such as loans from other local authorities which tend to be cheaper than PWLB.

16.9. An average interest rate of 4.5% is currently being used for budget estimates, derived from assuming PWLB borrowing over a 50-year period. Further work is required to quantify a blended notional interest rate that reflects the Council's overall approach to treasury management.

16.10. The interest rate forecasts for 2024/25 use advice received from Arlingclose, the Council's Treasury Management advisers, and is based on their assumption of declining interest rates from 2024/25 and onwards. More detailed advice from the advisers on interest rates is given in the 2023/24 Treasury Management Strategy.

16.11. MRP costs of 2% on an Equal Instalments Basis. Further work is needed to finalise the MRP Policy and select a calculation method that reflects a prudent approach for this type of activity and is acceptable both to the S151 Officer and the Council's external auditor.

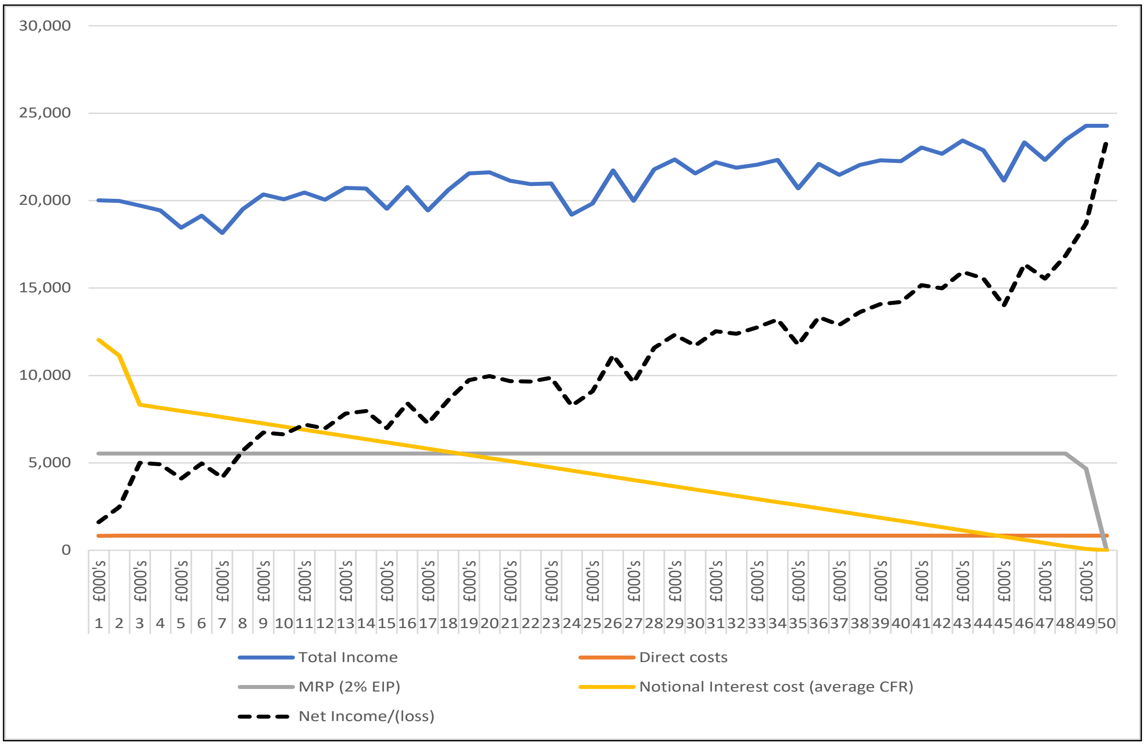
16.12. Financing costs are expected to reduce as the overall balance of CFR reduces each year. Costs will vary depending on the CFR balance and the interest rates than can be obtained each year.

16.13. Rental income is assumed to increase by 2% in a five yearly cycle. This is considered a prudent estimate for forecasting the average direction in the property market erring on the side of caution.

16.14. A cautious allowance has also been included in the model for void periods and the potential need for incentives such as a rent-free period for new tenants.

16.15. An assumption that the six properties that are currently void remain so over the modelling period, although all appropriate steps are being taken to improve on this assumption.

Chart Seven: Base mode in £000s (using Arlingclose interest rate forecasts)



16.16. Chart Seven above shows a fifty-year net income forecast (the dotted line) given the assumptions listed in the paragraphs above. (Year 1 is 2023/24). Rising interest rates are currently putting pressure on the investments achieving the net returns originally experienced when they were acquired.

16.17. The analysis shows that an estimated net return of 0.8% is forecast to be made in 2023/24 from the commercial property investments. This is at the overall portfolio level and is the estimated surplus after covering direct management costs, interest costs, and debt repayment. The net return however is very sensitive to interest rate changes and forecast rates going forwards. A 0.5% increase in interest rate assumption decreases the net return to 0.3%.

16.18. Net returns have also been calculated for each individual investment (not shown in this report), although the nature of the spread of investments means the return will vary from asset to asset based on many factors. The range is a negative 0.8% to a positive 4.5%, with 12 out of the 48 investments currently showing a negative return.

16.19. Chart Seven shows that the longer these investments are held, and as the outstanding debt is repaid off, the net return should increase. However, this analysis does not factor in potential risks relating to the individual investments (apart from potential void and rent-free periods) such as landlord capital costs and property obsolescence, nor the risks at portfolio level such as further legislative changes limiting local government holding these investments. A discussion of the potential risks associated with these investments is given in Appendix B of this report.

16.20. Whilst the overall conclusion from this financial analysis is that Somerset Council retains these investments immediately post vesting day: both the financial and property officers involved in this work could propose individual investments that would be more obvious candidates for selling should the Council wish to consider this post vesting day. A key further element of work that would be needed however to take this forward would be to obtain a more recent valuation of the individual investments before taking a final decision. The latest valuations date from the end of March 2022.

16.21. Regular review of the net return position for the portfolio as well as the individual investments will be needed post vesting day as proposed in strategic objective 2 (paragraph 11.5).

APPENDIX A: INVESTMENT PRUDENTIAL INDICATORS

Investment cover ratio:

This ratio shows how many times the total net income from non-treasury management investments relating to the Investment Properties can cover the interest costs associated with the outstanding indebtedness that has arisen from funding these investments. This demonstrates the Council' s ability to service this indebtedness.

Table: Four Investment Cover ratio: times interest cost covered by income					
Year ended	Gross Income	Direct costs	Net Income	Interest cost	Cover ratio
	£000's	£000's	£000's	£000's	Times
31/03/2024	20,015	840	19,175	12,033	1.6
31/03/2025	19,977	840	19,136	11,129	1.7
31/03/2026	19,712	840	18,872	8,331	2.3

Loan to value ratio:

This is the amount of indebtedness currently held compared to the total asset value. In this instance, the asset value is the total value of the Council' s property investments made primarily for yield. This illustrates whether the Council has assets of sufficient value to repay debt if required.

It should be noted that the Asset Valuation is the latest one undertaken, as at 31 March 2022. The next valuation will be undertaken for the 2022/23 Statement of Account (as at 31 March 2023) and is not yet available.

Table Five: Loan to Value ratio: % Closing CFR to Asset Valuation			
Year ended	Closing CFR	Asset Valuation	Cover ratio
	£000's	£000's	%
31/03/2024	264,628	264,167	100%
31/03/2025	259,097	264,167	98%
31/03/2026	253,566	264,167	96%

Total investments made primarily for yield as a proportion of total capital financing requirement (CFR):

This shows how much of the Council' s overall CFR (indebtedness) (excluding Housing Revenue Account CFR) pertains to property investments made primarily for yield.

Table Six: % Property Investments CFR to Total CFR			
Year ended	Closing CFR	Total CFR	Cover ratio
	£000's	£000's	%
31/03/2024	264,628	1,022,100	25.9%
31/03/2025	259,097	1,031,000	25.1%
31/03/2026	253,566	1,015,700	25.0%

Income returns:

Net revenue income from commercial properties compared to the value of the property investment portfolio. This represents the yield of the portfolio as a whole – generally, the higher the percentage the better the performance of the portfolio. However, the better the quality of the asset and the tenant, the lower the yield is likely to be. Therefore, a balance needs to be struck between high yield and good quality assets.

Table Seven: Income return: % net compared to Asset Valuation			
Year ended	Net income	Asset Valuation	Cover ratio
	£000's	£000's	%
31/03/2024	1,611	264,167	0.61%
31/03/2025	2,476	264,167	0.94%
31/03/2026	5,010	264,167	1.90%

It should be noted that the Asset Valuation is the latest one undertaken, as at 31 March 2022. The next valuation will be undertaken for the 2022/23 Statement of Account (as at 31 March 2023) and is not yet available.

Gross and net income:

The income received from the Council' s investment portfolio at a gross level and a net level (after the deduction of operating costs, interest & MRP). These figures have been incorporated into the 2023/24 and MTFP revenue budget estimates.

Table Eight: Gross & Net income			
Year ended	Gross income	Net income	Cover ratio
	£000's	£000's	%
31/03/2024	20,015	1,611	8.1%
31/03/2025	19,977	2,476	12.4%
31/03/2026	19,712	5,010	25.4%

Net Commercial Income to Net Service Expenditure:

This indicator measures the Council' s dependence on the income investments made primarily for yield to deliver core services. It indicates proportionality and whether the authority is taking too much risk in aggregate.

Table Nine: Net Income to Council's Total Net Service cost			
Year ended	Net income	Net Service cost	Cover ratio
	£000's	£000's	%
31/03/2024	1,611	494,820	0.33%
31/03/2025	2,476	542,070	0.46%
31/03/2026	5,010	588,000	0.85%

APPENDIX B: RISK ANALYSIS AND MITIGATION MEASURES

Risk appetite: can be defined as "the amount of risk that an organisation is prepared to accept, tolerate, or be exposed to at any point in time". Risk always exists in some measure and can never be totally removed.

The new Somerset Council will need to develop its risk appetite regarding these investments. This will be facilitated by the establishment of an Investment for Yield Performance Review Board as proposed in a previous section of this report. This section on risks applies to all the non-treasury management investments.

At the time of writing this report, it has been assumed that Somerset Council will accept these potential risks at vesting day. The rest of this section describes the key risks involved, giving a monetary value for the total risk exposure, where possible, the likelihood of the risk happening (High, Medium, Low), and proposed mitigation measures.

The potential risks involved can be broadly categorised into two major areas:

- Potential risks at the individual investment and overall portfolio level.
- Potential risks arising from economic and legislative changes

Each predecessor district council built up earmarked reserves to help finance the cost of the potential risks should they arise. It is estimated that the four districts will transfer around £10m in reserves for this purpose on 1 April 2023. This represents some 50% of the 2023/24 gross annual rental income budget from the commercial property investments. A full review of the reserves position will be undertaken during 2023/24.

Potential risks at the individual investment and overall portfolio level:

Risk that loans made to 3rd party organisations are not repaid

Likelihood: This is considered low risk for service investments given the nature of the organisations the predecessor councils have lent to. In terms of SSDC Opium Power Ltd (SSDC OPL) it is considered to be low to medium as the loan is secured against the assets, principal repayments are being made in line with the loan agreement, and two out of the three companies are now trading at a profit.

Total risk exposure: For service investments - £6.6m.
For loans made to SSDC Opium Power Ltd and subsidiaries - £39m.

Risk Mitigation: For new service lending this will include undertaking proportionate:

- Credit rating checks
- Analysis of the financial health of the organisation
- Review of the Business Case on how the loan is to be used
- A consideration of a legal charge on the borrower's assets
- Risk Mitigation for SSDC Opium Power Ltd and subsidiaries:
- Lending secured against the assets of the companies.
- Active involvement and monitoring of the JV company is a fundamental mitigation to protect the lending and value of the shareholding.
- Suitable governance for selection of Council appointed directors.
- Monitoring that joint venture companies are correctly resourced in terms of management, advisers, and contractors.
- Appointment of appropriate expert advice when required.
- Full records and documentation for use of Council and compliance with Council

accounting, standards, and procedures.

Risk that there are void rental periods

Description: Voids arise from having the property vacant (end of lease and inability to attract a new tenant, or tenant bankruptcy) or from negotiated rent free periods. The former the situation would mean not only the loss of rental income but the requirement to cover property costs such as Business Rates, void service charges, insurance, and security.

Voids frequently require some landlord capital spend to protect the long-term performance of the asset and achieve the best outcome on re-letting. There are fees to be met for letting agents and lawyers. Most new leases include a rent-free period as part of the letting package. Attempts to depart the normal mix of rent levels, lease terms and incentives are likely to frustrate the ability to re-let.

Likelihood: Low/medium: Currently there are six void properties. Most of the properties acquired are below £10m which means less risk of a single large tenant failing.

Total risk exposure: The current gross rental income is £20m.

The table below shows when leases end over the next few years and the rental income that would be at risk if a new lease is not obtained.

Table Ten: Lease end dates over the next few financial years

Financial Year	No of Properties	Rental income at risk £000's	% of overall income at risk
2022/23	9	£966	5%
2023/24	8	£1,388	7%
2024/25	8	£1,012	5%
2025/26	11	£2,533	13%
2026/27	14	£3,072	15%
2027/28	8	£1,622	8%
2028/29	7	£1,358	7%
2029/30	7	£2,004	10%

A small proportion of the properties are judged to involve greater short-term risk:

- M&S retail property at Yeovil (lease ends 31/03/27 – rental £505k pa; market rental value below 60% of passing rent and difficult to re-let)
- Wilko retail property at Yeovil (lease ends 28/04/25 – rental income £435k pa; market rental value below 50% of passing rent and difficult to re-let)
- Lyndon Place office in Birmingham (lease ends 31/10/2026; costly and difficult capital works required; high risk of void – rental income £196k pa)
- NCP (car park) in Bournemouth (tenant defaulted on lease; 12 month rolling agreement, ongoing risk, £200k pa income)

Risk mitigation:

For new tenancies undertake:

- Credit rating checks on tenant
- Analysis of a tenant' s financial health, business operations, and future performance
- Consider asking for a deposit from the tenant

For overall portfolio tenancies:

- Establish and maintain robust lease events calendar system and regular monitoring with structured arrangements for action triggers.

- Undertake prudent and realistic annual budgeting for income and costs.
- Proactively manage tenant relationships and intended tenant activity with the objective to secure the highest proportion of lease renewals rather than lease ends and re-letting.
- Proactively market new lease opportunities in a timely manner to minimise letting void periods.
- Retain earmarked risk mitigation reserve for these investments.

Risk that the building condition requires Council expenditure

Risk explanation: Properties may need expenditure to remain attractive to the market or to comply with current or future legislative standards, such as meeting the new Energy Performance Certificate (EPC) standards.

Review of the investment for yield portfolio has not yet identified any unit with an EPC rating worse than E although the review has a small proportion of properties yet to confirm. There will be future management needed for this as the EPC requirements will be increased to the point where a required rating of 'B' or above has been proposed to be needed by 2030.

Total risk exposure: short term risk is already addressed in capital budgets. Modelling should be undertaken to assess this component of risk reserve levels for the medium/long term.

Risk mitigation:

- Dilapidations at lease end are mostly at the expense of the tenant.
- Formal review of all existing let units should identify limitations on tenant repair obligations such as schedule of condition.
- Develop and maintain a robust capital budget for landlord expenditure at every potential lease expiry having regard to potential shortfalls in tenant dilapidations and reinstatement, key risks around building services, and aspects of building upgrades considered optimum for medium term income performance and lettability.
- Ensure management of the dilapidations processes are delivered in line with best practice to minimise cost impact to Council.

Risk that the portfolio is overexposed to certain property sectors and/or geographical locations

Risk explanation: There is more risk in owning a property portfolio where there is limited diversification in terms of geographic location and / or tenancy/property sector invested in.

Likelihood: The commercial property portfolio is diversified in terms of property sector and geographic location. This diversification reduces the risks of exposure to a single asset, tenant, or sector failure.

The portfolio at first glance may appear overweight in retail, but this is mitigated by the mix of high street, out of town, and retail warehouse properties. These are distinct sub-sectors performing quite differently.

Most substantial commercial property investors aim to achieve some portfolio churn in the medium term, selling properties when they offer the peak opportunity to realise capital growth or evolve the balance of the portfolio to respond to future or past changes in sector performance.

However the potential to pro-actively manage the portfolio appears severely limited by the terms of Prudential Code. The meaning of clauses in the Code referring to rebalancing and improvements may be clarified when the policy has been in use for some years.

Risk mitigation:

Whenever the highest-level strategy for commercial investments is set or revised, assessment should be made as to whether to seek recommendations for any properties for disposal due to issues of portfolio balance.

Risk that the Council may not receive the value invested if it sells

Risk explanation: property values can go up and down and there is the risk that the council can make a loss on the sale. Values are prone to fluctuation, for a range of reasons. These include economic shifts, changes in strategic investor requirements, financial market shifts, sector relative pricing, changes in the locality, or asset specific risks, such as tenant failure.

Likelihood: There is an immediate post-acquisition loss of the costs of purchase – assumed to be typically 6.8% of purchase price for Stamp Duty Land Tax and advisory fees. Shorter lease properties, or those where the contracted rent is well above the market rent, tend to progressively reduce in capital value as the lease term reduces. The capital value should return to the best level following successful reletting. In the case of over-rented properties, the eventual value is expected to be below purchase price.

Total exposure: The unaudited value of the investments as at the end of March 2022 are £264m. As compared to the total investment made (£289m) this is a decrease in value of £25m (9%), which is in part expected as initial costs include sunk costs such as taxes and fees above the purchase price. A new valuation will be undertaken to produce the 2022/23 Statement of Accounts, and as at 31 March each year thereafter. Any gains and losses in valuation do not impact on the budget or useable reserves, instead being written off to the Revaluation Reserve and Capital Adjustment Account. Any future actual disposal net proceeds are treated as capital receipts, and it is proposed these will be prioritised to reduce the Capital Financing Requirement (borrowing). If the proceeds fall short of the CFR balance at the time the residual amount will remain to be funded through the annual revenue charge for debt repayment (MRP) or other capital receipts set aside for debt repayment.

Risk mitigation: The council will undertake proportionate due diligence including:

Market Testing – The general presumption should be that any sale of an investment property asset should be subject to an open market sale where reasonable steps have been taken to identify all interests in acquiring the asset subject to expert advice on how best to optimise the value of the sale. There may be situations of a possible "special purchaser" – such as the tenant or owner of neighbouring property – where the price cannot be tested by general marketing. In any such cases, prior approval to engage would be confirmed with the Investment for Yield Performance Review Board. Confirmation that the negotiated price is appropriate and in excess of normal market value will be confirmed by external valuation.

Valuation – When an assessment is being made of whether to sell, advice should be obtained from appropriate specialists on expected selling price as well as best approach to marketing. An external investment agency firm is most likely to be used for sales and they should provide appropriate formal advisory recommendations.

Pre-sales due diligence – prior to any marketing, good practice due diligence should be completed to include legal work on perfecting title; resolution of management matters and assembly of good records and completion of any appropriate data room. The aim is to enable the sales process to progress in the easiest way and be able to close out any intended transaction with the risk that is involved with delays or unknowns coming to light.

Risk that the Council may not receive cash quickly if it wants to sell

*Risk expla*nation: commercial investment property is relatively illiquid. Key reasons are that disposal must involve the whole property interest, and it involves a process of individual marketing, negotiation, due diligence, and then legal transaction. This is demanding and slow compared with assets such as equities, bonds, or investment units. Values are prone to fluctuation, particularly due to changes in the locality, the general economic outlook, or asset specific risks, such as tenant failure. The market is impacted by changes in confidence. Sharp economic downturn may lead to a period of severely restricted buyer demand.

Likelihood: The market fundamentals for this asset class are a fixture which cannot be avoided, and part of the context for direct investment in property. Extreme market cycles are occasional but difficult to predict.

Total exposure: This depends on the high-level strategy. If the intention is a long term "hold" then this risk is in the background. The current Prudential Code means the council could not operate as a "trader" in investment property. If there is an intention to partly or fully divest from the property investment portfolio, this can be planned to be delivered when market conditions are helpful and in an orderly programme.

Risk mitigation:

- Long term cash management planning so that shorter term capital requirements do not need to be linked to property investment sales.
- Any divestment options for investment property should be considered with strategic advice as to the expected market conditions and values, and if implemented then the approach should allow a reasonable time-period for sales to be concluded.
- A high-level strategy for the property investment objectives needs to be formulated and periodically reviewed. This will set and re-set the intentions as to the extent of divestment, if any.
- The property investment team should review the legal package for each asset, manage the physical assets, and tenant relationships and records so that there is a general situation of readiness should there be a decision to sell. Presale packs prepared before any property is put on the market.

Potential risks arising from economic and legislative changes:

Unfavourable economic outlook

Risk explanation: Property financial performance is closely related to factors in the general economy. Including prevailing interest rates.

Likelihood: A significant proportion of the capital financing requirement is currently financed through internal borrowing (which reduces treasury investment risk) and through short term loans. The Council will need to replace short term loans and may need to externalise internal borrowing and is therefore exposed to the interest rates available when refinancing decisions are made. If the cost of borrowing increases this adversely impacts on net income available to fund services.

It is considered highly likely that interest rates will continue to rise for the next 1-2 years but then begin to fall. It is considered unlikely the rates will return to the historic lows seen on the past decade.

Total Exposure: The estimated CFR on 1 April 2023 is £264m. 1% volatility in interest costs for a full year would be £2.64m.

Risk Mitigation:

- Prudent estimates of anticipated interest costs used for the budget.
- Taking advice from Arlingclose on a prudent treasury management approach to support the Council's overall approach to investment and borrowing.

- Holding adequate reserves to withstand adverse budget variances.
- Applying MRP to reduce debt and therefore the amounts required to be refinanced.

Risk of further changes to legislation

Risk explanation: Government and CIPFA have undertaken significant changes to legislation and guidance over recent years regarding investments made for yield with the impact of restricting activity by councils in this area. There could be further legislation in the future.

Likelihood: Government has already consulted in changes that would require councils to provide Minimum Revenue Provision (MRP) on lending to third party organisations (see Appendix C).

There is also a possibility that enforcement will result in investment for yield investments having to be held via a company structure rather than directly by councils.

Risk mitigation: to keep aware of possible legislative changes and respond to any further consultations.

APPENDIX C: RELEVANT REGULATORY FRAMEWORK

Borrowing from the Public Works Loan Board (PWLB)

On 26th November 2020 HM Treasury introduced new lending terms for the PWLB. Guidance issued at that time was further clarified and updated on 21st August 2021.

The changes mean that local authorities will be unable to borrow from the PWLB to finance any expenditure in their capital budgets if they are planning to acquire new investment assets bought primarily for yield in any of the following three financial years.

Local authorities cannot use the receipts from selling investments made for yield to acquire new investment for yield assets. Local authorities can only use the receipts from selling these investments to finance other capital expenditure in service delivery, regeneration, housing, and preventative action, or to repay capital debt.

HM Treasury advise that investment assets bought primarily for yield would usually have one or more of the following characteristics:

- buying land or existing buildings to let out at market rate,
- buying land or buildings which were previously operated on a commercial basis which is then continued by the local authority without any additional investment or modification,
- buying land or existing buildings other than housing which generate income and are intended to be held indefinitely, rather than until the achievement of some meaningful trigger such as the completion of land assembly, and
- buying a speculative investment asset (including both financial and non-financial assets) that generates yield without a direct policy purpose.

This does not prevent local authorities from borrowing for projects that are primarily for other purposes, but which also happen to generate a financial yield.

Local authorities are also able to borrow from the PWLB to finance capital expenditure to maintain existing commercial investments or to fund capital investment needed to increase their value prior to disposal.

Any investment bought primarily for yield which was acquired after 26th November 2020 results in the local authority not being able to use the PWLB to refinance this transaction at any point in the future. Such investments acquired, or contractually committed, prior to 26 November 2020 will not affect the local authority’s access to the PWLB.

As a condition of accessing the PWLB, Local Authorities must submit a high-level description of their capital spending and financing plans for the following three years, including their expected use of the PWLB. The S151 Officer needs to confirm that there is no intention to buy investment assets primarily for yield at any point in the next three years. This assessment is based on their professional interpretation of guidance issued.

CIPFA Prudential Code

The Local Government Act 2003 requires Local Authorities to “have regard to” the Chartered Institute of Public Finance and Accountancy (CIPFA) Codes of Practice and they must explain their rationale and get Council approval if they choose to disregard this guidance.

A revised Prudential Code was published in December 2021. Some of the requirements of the revised Code applied with immediate effect following publication; including the stipulation that an authority must no longer borrow to invest primarily for a financial return.

Other changes could be delayed until 2023/24 including the requirement to annually review investments held primarily for yield with a view to divesting where appropriate. Relevant extracts from the Code are given below.

Authorities with existing commercial investments (including property) are not required by this Code to sell these investments.

Such authorities may carry out prudent active management and rebalancing of their portfolios, including repair, renewal and updating of the properties.

However, authorities that have an expected need to borrow should review options for exiting their financial investments for commercial purposes and summarise the review in their annual treasury management or investment strategies.

The reviews should evaluate whether to meet expected borrowing needs by taking new borrowing or by repaying investments, based on a financial appraisal that takes account of financial implications and risk reduction benefits.

CIPFA revised Treasury Management Code (2021) and DLUHC Statutory Guidance on Local Authority Investment Activity (2018)

These essentially contain the same statutory guidance with respect to non- treasury management investments. They contain requirements for councils to:

- Prepare an annual Investment Strategy which must be approved before the start of the forthcoming financial year by full Council.
- Ensure the strategy is publicly available on a local authority's website.
- Disclose the contribution that all non-treasury management investments make towards the service delivery objectives and/or place making role of that local authority.
- Include quantitative indicators within the strategy, that allow Councillors and the public to assess a local authority's total risk exposure because of its investment decisions. This should include how investments are funded and the rate of return.

The guidance requires that councils should consider the long-standing treasury management principles of security, liquidity, and yield (in that exact order) when considering non-treasury investments. These principles are briefly explained below:

- Security - Safeguard the value of, and expected returns from, the council's investment.
- Liquidity - Ensure the investment can be quickly divested to meet the council's cash flow requirements.
- Yield (the net return achieved from the investment) - Investment return is the final objective and should be considered after the security and liquidity requirements have been satisfied.

Minimum Revenue Provision (MRP)

MRP is the minimum amount which a council must charge to its revenue budget each year, to set aside a provision for repaying external borrowing (loans) and/or internal borrowing. It is the statutory duty for each authority to determine each year an amount of MRP that it considers to be prudent in accordance with section 21(1A) of the Local Government Act 2003 (revised 2018).

Recent consultations by DLUHC (Department for Levelling Up, Housing and Communities) indicate they would like to reform the guidance around MRP and, specifically with reference to non-treasury management investments, legislate councils to provide MRP on a debt which relates to investment for yield assets or capital loans made for yield or for service purposes. The legislation has been delayed and has not yet been introduced. However, the Council's MRP policy will include the approach recommended by the S151 Officer as a prudent provision notwithstanding future guidance.

Legislation regarding the sale of property investments

Compliance with Section 123 of the Local Government Act 1972 will be required which states that "except with the consent of the Secretary of State, a council shall not dispose of land under this section, otherwise than by way of a short tenancy, for a consideration less than the best that can reasonably be obtained".

Energy Performance Certificates (EPC)

Energy Performance Certificates (EPCs) set out how energy-efficient a property is from A (most efficient) to G (least efficient). They also show the potential level of emissions and associated costs of improving the rating for that property. Owners must obtain an EPC whenever a property is built, sold, or rented.

From April 2023, it will be a legal requirement for all commercially rented properties to have an EPC (Energy Performance Certificate) rating of at least E. This is currently a legal requirement for commercial properties before they can receive a new or renewal lease, but from next year this requirement will be extended to both new and existing commercial leases too.

The responsibility for obtaining an EPC is with the landlord of a property except where a lease is in place with an original term more than 99 years.

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Somerset County Council
Audit Committee
– 2nd February 2023

Capital Strategy 2023/24 to 2025/26
Lead Officer: Jason Vaughan, Director of Finance and Governance
Author: Donna Parham, Head of Corporate Finance and Deputy S151.
Executive Lead: Cllr Liz Leyshon, Deputy Leader and Lead Member Finance and HR
Division and Local Member: All

1. Summary

1.1. The Government requires all local authorities to produce a Capital Strategy each year. This is the overarching document which sets the policy framework for the development, management, and monitoring of capital investment. Lending to other organisations and commercial investments are now covered under the Non-Treasury Investment Strategy.

1.2. The Capital Strategy focuses on core principles that underpin the council's capital programmes both General Fund and Housing Revenue Account, the financing and the risks that will impact on the delivery of the programme; and the governance framework required for decision making and delivery.

2. Issues for consideration / recommendations

2.1. The Committee is asked to review the Capital Strategy for 2023/24 to 2025/26, whether there are any suggestions for amendments that they would like to recommend to the Executive.

3. Background

3.1. The statutory guidance requires the Authority to approve a Capital Strategy each year and the associated Prudential Indicators.

3.2. The appendix attached sets out the capital strategy for the new Somerset Council and includes the financing of both the General Fund Capital Programme and the programme for the Housing Revenue Account. It assumes that the position of each capital programme as at quarter 2 is accurate. The capital programme for Somerset Council will need to be amended once the outturn position of the five Somerset authorities is known to enable projects that may actually finish later than the 31st March 2023 to be completed. The Prudential Indicators may need revising once this has been assessed.

4. Consultations undertaken

4.1. This strategy has been compiled through consultation with each authority and their estimates for debt, investments and capital spending.

5. Implications

5.1. The strategy is designed to fully comply with the Prudential Code of Practice for Local Authority Capital Investment by the Chartered Institute of Public Finance and Accountancy (CIPFA) in parallel with guidance to local authorities from the Department of Levelling Up, Housing and Communities (DULHC) The main purpose of the Code is to ensure that capital investment proposals are affordable, prudent and sustainable.

5.2. The financial implications of the Strategy are included within the 2023/24 budget.

5.3. There are no specific HR implications arising from this report.

6. Background papers

6.1. None

Note For sight of individual background papers please contact the report author

Somerset Council

Capital Strategy 2023/24– 2024/26

Capital Strategy Report 2023/24

Contents

1. Background and Context

This capital strategy for 2023/24 gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. This is the first strategy for the new Somerset Council which combines the programmes of all five Councils for the first time.

It addresses the capital components of the wider financial strategies adopted by the Authority. It identifies the links and relationships that need to be made in considering and implementing the Capital Programme to support the emerging Unitary Plan objectives. This is done through the Medium-Term Financial Plan (MTFP) and alerts services to the governance and control framework within which the investment planning and delivery takes place.

This is the first budget setting process for Somerset Council, and this is reflected in the strategy taken towards capital approvals. Firstly, by reviewing priorities and slippage in the short-term to reduce the capital programme. Secondly it constrains new programme approvals to only those that are Health and Safety related, those with the highest priority, and those that are wholly externally funded. This strategy therefore has a focus for 2023/24 but as decisions made this year on capital and treasury management will have financial consequences for many years into the future the potential implications for forward years are set out.

It is clear that the programme will need to be revisited post vesting day. This will enable the new authority to review projects alongside the new Corporate Plan, In addition to this we have requested that all five authorities do not reprofile their programmes after Quarter 2. This enables the new authority to set a programme for 2023/24 but on the understanding that the capital projects currently being delivered will have year end balances that will require reviewing and updating. Therefore, a revised programme will need to be set in Quarter 1 or Quarter 2 of 2023/24.

This report summarises the requirements of and compliance to both national regulatory and to local policy frameworks. Both the Prudential Code and Treasury Management Code have been revised during December 2021. The revised Codes include clarification and examples of what is and is not classified as prudent borrowing activity. These added principles are intended to protect the public purse and avoid misinterpretation of the Code's provisions. The focus is around strengthening the governance and transparency arrangements surrounding commercial activity as well as actively discouraging this activity funded by borrowing. The other edits include proposing of a liability benchmark to be adopted as a treasury management tool over the coming year and integration of Environmental, Social and Governance risks into the policy framework.

The Capital Programme is the term used for the Council's rolling plan of investment in both its own assets and those of its partners. The programme spans multi-years and contains a mix of individual schemes, many spanning more than one year. Some schemes will be specific investment projects while others may provide for an overarching schedule of thematic works e.g. "Highways".
Investing in assets can include expenditure on:

- Infrastructure such as highways, open spaces, coast protection;
- New build;
- Enhancement of buildings through renovation or remodelling;
- Major plant, equipment and vehicles;
- Capital contributions to other organisations enabling them to invest in assets that contributes to the delivery of the Council's priorities.

The Capital Programme is distinct from the Council's revenue budget which funds day-to-day services, but they are both linked and are managed together. This ensures they contribute to the Council's objectives set out in the Corporate Plan to achieve the most beneficial balance of investment within the resources available.

There is a strong link with the Treasury Management Strategy[1] that provides a framework for the borrowing and lending activity of the Council supporting the historic investment programme. This capital strategy, non-treasury investment strategy, and the capital MTFP align to service planning and the corporate asset strategy. Asset information is overseen by the Asset Strategy Group which manages the built estate as Corporate Landlord and additional (non-property information) is maintained by Services.

2. Capital Expenditure and Financing

Capital expenditure occurs when the Council spends money on assets, such as property or vehicles, that will be used for more than one year. In local government this also includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets.

The Council has the ability to set a de-minimis level to capture only significant assets, however does not opt to do so. This allows the Council to review every item of expenditure and capitalise as appropriate.

[1] Treasury Management Strategy link: *to be added when approved at Full Council*

In 2023/24, the Council is planning capital expenditure of £279.8m. The following table shows our planned spend for the future:

Table 1: Estimates of Capital Expenditure

	2022/23 forecast Q2 All Somerset Authorities £m	**2023/24 Somerset Council budget £m**	**2024/25 budget £m**	**2025/26 budget £m**
Capital Expenditure HRA (Housing Revenue Account)	46.8	46.8	37.8	33.7
Capital Expenditure GF (General Fund)	180.2	233.0	58.2	20.1
Total Capital Expenditure	**227.0**	**279.8**	**96.0**	**53.8**

This table includes an overview of capital spend – including historic County and District Council, General Fund and the Housing Revenue Account spend, to enable comparisons across years to be made. It includes both the current approved capital programme and the proposed 2023/24 programme due to be put to Full Council on 22nd February 2023. For example, the 2023/24 General Fund budget of £233.0m is made up of £170.5m current programme and £62.5m 2023/24 proposed new schemes.

The Housing Revenue Account (HRA) is a ring-fenced, self-financing, account used to manage the Council's housing stock. Somerset Council acts as the Landlord to the tenants of properties in Somerset West and Taunton, whereas the properties in Sedgemoor are managed through an ALMO (Arms-Length Management Organisation) The HRA has its own ring-fenced revenue account, capital programme and reserves. This ensures that council housing neither subsidises, nor is itself subsidised by, Council Tax-payers. The HRA Capital Programme's main purpose is to invest in the housing portfolio to replace major components periodically, to ensure that the decent homes standard and warmer homes standards are maintained and that fire safety regulations are adhered to.

Within the General Fund service managers bid annually to include projects in the Council's capital programme. Bids are collated by corporate finance who calculate the financing cost (which can be nil if the project is fully financed). The bids are appraised against a set criterion including a comparison of service priorities against the affordability of the financing costs. Director Groups of previous County and District Councils have undertaken a final review before the draft capital programme is then presented to relevant Scrutiny Committee(s) prior to its consideration by the Cabinet in February for recommendation to Council in February each year.

For full details of the Council's 2023/24 capital programme, see the main 2023/24 Budget and MTFP report within the papers to Full Council on 22nd February 2023.

All capital expenditure must be financed, either from external sources (government grants and other contributions such as S106 and CIL), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing - HRA

	2022/23 forecast Q2 All Somerset Authorities £m	**2023/24 Somerset Council budget £m**	**2024/25 budget £m**	**2025/26 budget £m**
Major Repairs Reserve	20.9	18.1	17.8	18.5
RTB Receipts	4.7	4.2	8.5	8.3
Grants	3.2	1.5	0.3	
Other Capital receipts	1.6	0.8	11.2	2.4
RCCOs	-	1.2	-	-
Debt	16.4	21.0	-	4.5
TOTAL	**46.8**	**46.8**	**37.8**	**33.7**

Table 3: Capital financing - General Fund

	2022/23 forecast Q2 All Somerset Authorities £m	2023/24 Somerset Council budget £m	2024/25 budget £m	2025/26 budget £m
External sources	82.4	129.6	19.1	3.5
Own resources:				
Capital receipts	13.0	6.4	2.9	2.8
Revenue / Reserves	5.50	0.1	0.1	0.1
S106/CIL	10.2	10.8	4.4	4.4
Debt	69.1	86.0	31.7	9.3
TOTAL	**180.2**	**233.0**	**58.2**	**20.1**

Debt 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). Planned MRP budgets are as follows:

Table 4: MRP for the repayment of General Fund debt

	2022/23 forecast Q2 All Somerset Authorities £m	2023/24 Somerset Council budget £m	2024/25 budget £m	2025/26 budget £m
Own resources	15.1	21.4	22.7	24.5

- Note Depreciation rather than MRP is used for HRA debt
- Note 22/23 includes voluntary MRP of £3.7m
- The Council’s full minimum revenue provision statement is available as part of the 2023/24 Budget and MTFP papers to Full Council on 22nd February 2022.

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 and reduces with MRP, lease principal repayments and capital receipts used to replace debt. The CFR is expected to increase by £95.9m during 2023/24. It is worth noting that the Housing Revenue Account uses depreciation and therefore MRP is not charged to the HRA. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 5: Prudential Indicator: Estimates of Capital Financing Requirement

	2022/23 forecast Q2 All Somerset Authorities £m	**2023/24 Somerset Council budget £m**	**2024/25 budget £m**	**2025/26 budget £m**
Housing Revenue Account	189.3	210.3	210.3	214.8
General Fund	945.2	1,022.1	1,031.0	1,015.7
TOTAL CFR	**1,134.5**	**1,232.4**	**1,241.3**	**1,230.5**

It is important to ensure capital plans are affordable and the Council can meet the costs of this debt over both the short- and long-term. The Council' s Medium Term Financial Plan reflects the impact of debt financing costs on revenue budgets in future years. In relation to Housing Revenue Account assets, the HRA Business Plan sets out the impact of capital expenditure over a 30-year period. Other measures of affordability are contained within the prudential indicators set out in the Treasury Management Strategy.

Asset disposals: When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. Repayments of capital grants, loans and investments also generate capital receipts. The Somerset Councils plan to receive £6.3m of capital receipts in the current financial year, £11.0 in 2023/24, and have £18.7m banked from previous years as at the 31st March 2022.

Table 7: Capital receipts – General Fund

	2022/23 forecast Q2 All Somerset Authorities £m	2023/24 Somerset Council budget £m
TOTAL asset sales	**6.3**	**11.0**

Department for Levelling Up, Housing and Communities (DLUHC) have issued a revised 'flexible use of capital receipts' directive. This allows projects which will save revenue budget to be funded from capital receipts. This directive was issued in 2016 and as part of Government announcements in February 2021 this is extended to March 2026. The authority's expected use of receipts under this directive for 2022/23 and 2023/24 is expected to be a total of £15.9m. The Flexible Receipts Strategy outlines that the flexibility will be utilised to fund eligible Local Government Reorganisation costs in 2022/23 and 2023/24'. The Strategy will be presented to full Council approval as part of the MTFP and Budget Setting Report.

3. Treasury Management

Treasury management is the activity of keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council typically runs a cash surplus in the short term, particularly at the start of the financial year, as revenue income is received before it is spent.

Due to decisions taken in the past, all of the Somerset authorities have long-term borrowing of £400.3m at an average interest rate of 4.17% within the General Fund and £148.6m at an average interest rate of 2.81% within the HRA. The new authority will continue to maximise the use of the cash held before taking costly external debt, this is referred to as internal borrowing.

The budget for debt interest paid for General Fund debts in 2023/24 is £31.2m, based on an average debt portfolio of £835.5m at an average interest rate of 3.84%. The budget for Treasury and strategic investment income in 2023/24 is £13m based on an average investment portfolio of £350m at an average return of 3.75%. (These figures are net of balances held on behalf of external investors i.e. the Local Enterprise Partnership).

Borrowing strategy: The Council's main objectives when borrowing continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. It strives to achieve as low but more certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between internal borrowing, cheaper short-term loans, and long-term fixed rate loans where the future cost is known but is at higher rates.

Table 8: Prudential Indicator: External Debt and the Capital Financing Requirement

	31.3.2023 forecast £m	**31.3.2024 budget £m**	**31.3.2025 budget £m**	**31.3.2026 budget £m**
Short term debt	N/A	210.0	210.0	210.0
Long term debt *	N/A	522.8	511.5	499.6
Assumed debt not yet taken	N/A	261.0	260.0	274.5
PFI & leases	N/A	77.3	76.0	74.7
Total external borrowing	**N/A**	**1,071.1**	**1,057.5**	**1,058.8**
Housing Revenue Account	189.3	210.3	210.3	214.8
General Fund	945.2	1,022.1	1,031.0	1,015.7
Total CFR	**1,134.5**	**1,232.4**	**1,241.3**	**1,230.5**

*(reduces for MRP set aside & actual debt repayments)

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, the Council expects to comply with this in the medium term.

Affordable borrowing limit: The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

Table 9: Prudential Indicators: Authorised limit and operational boundary for external debt

	2022/23 limit £m	2023/24 limit £m	2024/25 limit £m	2025/26 limit £m
Operational boundary – borrowing	N/A	1,004.4	1,013.1	1,015.7
Operational boundary – PFI and leases	N/A	79.3	78.0	76.7
Operational boundary – total external debt	**N/A**	**1,083.8**	**1,091.1**	**1,092.4**
Authorised limit – borrowing	N/A	1,039.4	1,048.1	1,050.7
Authorised limit – PFI and leases	N/A	84.3	83.0	81.7
Authorised limit– total external debt	**N/A**	**1,123.7**	**1,131.1**	**1,132.4**

Please note this includes General Fund and Housing Revenue Account

Treasury investments: is the management of the Council's cash flows, and treasury investments, and the associated risks. The Council has significant debt and treasury investment portfolios 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.

Investments made for service reasons or for the purpose of generating a positive income (net of costs), known as non-treasury investments, are not considered to be part of treasury management.

This capital strategy contains the prudential indicators approved by the Council. The Treasury management strategy contains further details on treasury investments criteria and governance. There are also 3 Treasury management indicators that are set out in section 4 of the Treasury Management Strategy for the adoption by the Council.

Risk management: No treasury management activity is without risk. The successful identification, monitoring and control of risks are the prime criteria by which the effectiveness of its treasury management activities will be measured. The main risks to the Council's treasury activities are:

- Credit and Counterparty Risk (security of investments)
- Liquidity Risk (inadequate cash resources)
- Market or Interest Rate Risk (fluctuations in price / interest rate levels)
- Refinancing Risk (impact of debt maturing in future years)
- Legal & Regulatory Risk.

The Authority's policy on treasury investments is to prioritise security and liquidity over yield; that is to focus on minimising risk rather than maximising returns in accordance with DLUHC guidance. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice. The strategy includes some prudential indicators which manage risk in setting the boundaries.

Governance: Decisions on treasury management investment and borrowing are delegated to the Director of Resources and staff, who must act in line with the annual treasury management strategy approved by Full Council each year. In formulating the Treasury Management Strategy, and the setting of Prudential Indicators, Somerset Council (SC) adopts the Treasury Management Framework and Policy recommended by CIPFA, see **appendix A** of the Treasury Management Strategy.

Further governance is provided by the comprehensive Treasury Management Practices (TMP's) which set out the main categories of risk that may impact on the achievement of Treasury Management objectives.

A mid-year and an annual outturn report on treasury management activity are presented to Full Council. The audit committee is responsible for scrutinising treasury management decisions.

Treasury (Commercial) investments: Describing the Council's approach to non-treasury investment is a requirement of the DLUHC.

With central government financial support for local public services declining, the Somerset District Councils explored the options of investing in non-treasury investments purely or mainly for financial gain. With financial return being the main objective, with this comes higher risk on commercial investment than with treasury investments. Borrowing to invest purely for commercial income gain is now strongly discouraged by Treasury, to the point the PWLB is explicit in not being used for this sole purpose. The revision to the Prudential Code, 2021, also tightens the regulatory controls on this type of activity. Given the complexity and value of the investments made a separate strategy for Non-Treasury Investments is required and will be presented as part of the MTFP and Budget Setting Report in February 2023.

4. Other long-term liabilities

In addition to debt detailed above, the Council is committed to making future payments to cover its pension fund deficit. The deficit reported in the 2021/22 accounts was £812.7m (as at 31/03/2022). It has also set aside £7m (as at 31/03/2022) as a provision to cover risks of insurance claims, business rate appeals and other legal claims. The Council is also at risk of having to pay for contingent liabilities but has not put aside any money because of the low risk and uncertainties around potential value.

Governance: Decisions on incurring new discretional liabilities will initially be considered by service managers for discussion with the relevant director. If it is recommended that the liability may be undertaken then the relevant director will consult with the Chief Finance Officer (S151 Officer), Monitoring Officer and Council Solicitor before any recommendation is made to the Senior Leadership Team prior to any decisions taken. Depending on the extent of the liability envisaged, it may be necessary to make a formal decision through a democratic process. The risk of liabilities crystallising and requiring payment is monitored by corporate finance and reported quarterly to audit committee. New liabilities exceeding £500m are reported to Cabinet and Full Council for approval.

- Further details on provisions and contingent liabilities are outlined in each Somerset Councils 2021/22 statement of accounts:

5. Revenue Budget Implications

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. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

Table 10: Prudential Indicator: General Fund Proportion of financing costs to net revenue stream

	2022/23 forecast	**2023/24 budget**	**2024/25 budget**	**2025/26 budget**
Financing costs (£m)	N/A	53.5	55.6	57.6
Proportion of net revenue stream	N/A	9.98%	9.68%	9.13%

Table 11. Prudential Indicator: Housing Revenue Fund Proportion of financing costs to net revenue stream

	2022/23 forecast	**2023/24 budget**	**2024/25 budget**	**2025/26 budget**
Financing costs (£m)	4.9	6.2	6.9	7.2
Proportion of net revenue stream	10.1%	12.1%	12.4%	12.8%

- Further details on the revenue implications of capital expenditure can be found in 2023/24 MTFP report to Full Council on 22nd February 2023.

Sustainability: Due to the long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend into the future years. The Director of Finance and Governance is satisfied the proposed new capital schemes are prudent, affordable and sustainable. This follows full challenge of all capital bids against a set criteria. There will however be a need to continually review the overall programme against the authority’s Corporate Plan and ongoing financial position to ensure that the capital programme continues to meet the objectives of the new authority.

Only schemes that will have fully approved funding in place are considered as part of the capital programme and the cost impact of borrowing forms part of the revenue medium term financial planning.

6. Knowledge and Skills

The Council employs professionally qualified and experienced staff in all positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Director of Finance & Governance and section 151 Officer will always be a qualified accountant with substantial experience and there is a range of significant experience and expertise within the Treasury Team. Where necessary, the Council pays for junior staff to study towards relevant professional qualifications, for example CIPFA.

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

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Somerset County Council
Audit Committee
– 2nd February 2023

Flexible Capital Receipts Strategy 2022/23 and 2023/24

Lead Officer: Jason Vaughan, Director of Finance and Governance
Author: Donna Parham, Head of Corporate Finance and Deputy S151
Executive Lead: Cllr Liz Leyshon, Deputy Leader and Lead Member Finance and HR
Division and Local Member: All

1. Summary

1.1. Central Government introduced legislation in 2015 that enabled local authorities to utilise capital receipts for once-off revenue expenditure which then resulted in ongoing savings. This has now been extended although some criteria have been amended until 2025.

1.2. This statement outlines Somerset Councils intention to utilise capital receipts to fund the once off costs of Local Government Reorganisation in Somerset for 2022/23 and 2023/24. The Business case outlined that £18.5m ongoing savings could be achieved with once-off funding of £16.5m. The flexibility will require up to £15.9m of capital receipts.

2. Issues for consideration / recommendations

2.1. The Committee is asked to review the Flexible Capital Receipts Strategy for 2022/23 and 2023/24, whether there are any suggestions for amendments that they would like to recommend to the Cabinet.

3. Background

3.1. The government allows local authorities to utilise capital receipts for once-off revenue costs. The ability for Somerset Council to utilise capital receipts will enable the new authority to retain revenue reserves by funding once-off LGR costs through capital receipts.

3.2. The appended report sets out the Authority's approach and the 2023/24 impact on the revenue budget.

4. Consultations undertaken

4.1. This statement has been reviewed with an assessment of the likely revenue reserves for the new council and consultation with the S151 Officer for Somerset Council

5. Implications

5.1. This statement is required under statutory legal guidance issued through the Local Government Act 2003 Sections 16(2)(b) AND 20: Treatment of Costs as Capital Expenditure

5.2. The financial implications of the statement directly impact the level of charge to the revenue budget. This will mean that capital receipts do not finance capital spending but this has been funded within the budget for 2023/24.

5.3. There are no specific HR implications arising from this report.

6. Background papers

6.1. None

Note For sight of individual background papers please contact the report author

Appendix A

Somerset Council – Flexible Capital Receipts Strategy (Revised 2022/23 and 2023/24)

1. Flexible Use of Capital Receipts

Central Government outlined in December 2015 that local authorities would be able under certain circumstances to utilise capital receipts for revenue expenditure in certain circumstances. The criteria for the application of capital receipts for revenue spend has gradually changed over time. The current rules that were introduced in 2021 outline that:

- Only receipts received within the timescales that authorities have a Flexible Receipts Strategy can be used
- Only receipts from PPE (Property, Plant, and Equipment) can be used where the authority ceases to have an interest in the asset
- The authority must be able to demonstrate that ongoing savings are a result of the application of receipts
- Discretionary redundancy payments cannot be funded from capital receipts, but statutory redundancy and pension strain payments are allowable

The current requirement states that the strategy should list each project that plans to make use of the capital receipts flexibility. Council approved the current strategy in February 2022. However, this was before further criteria were outlined by central Government. This Strategy therefore clarifies those outstanding points and will apply to both years.

2. Projects Which Meet the Criteria

The costs of Implementing Local Government Reorganisation meet the criteria. All use of flexible receipts will therefore be linked to the on-going savings plans of £18.5m outlined in the Local Government Reorganisation Business Case, The Strategy should report the impact on the local authority's Prudential Indicators for the forthcoming and subsequent years. The strategy in future years will monitor the performance of the savings delivered. The Strategy must be approved by Council and submitted to the Secretary of State. A revised strategy may be replaced by another during the year through the same approval process.

3. Savings Which Meet the Criteria

The Business case for Local Government Reorganisation in Somerset outlined ongoing savings of £18.5m with once-off implementation costs of £16.5m. In terms of Implementation Costs £599,755 was spent in 2021/22 and it is proposed that the remainder of £15,928,221 of expenditure for 2022/23 and 2023/24 as shown below will be financed from capital receipts with the exception of any discretionary redundancy costs.

Table 1 - LGR Implementation Costs

	2021/22 £m	2022/23 £m	2023/24 £m	Total £m
1. Programme Delivery	0.6	5.6	1.2	7,4
2. Redundancy	-	5.6	2.8	8.4
3. Unallocated		0.7		0.7
Total Implementation Budget	**0.6**	**11.9**	**4.0**	**16.5**

The budget for 2023/24 reflects this strategy.

4. The Capital Receipts to be Used this Purpose

Capital receipts from the disposal of property, plant, and equipment received in the years in which the flexibility is offered can be used for this purpose.

5. The Impact on Borrowing and Prudential Indicators

The impact of this has been reflected in the prudential indicators as part of setting the 2023/24 budget as follows:

Table 2 - Capital financing - General Fund

	2022/23 forecast Q2 All Somerset Authorities £m	2023/24 Somerset Council budget £m	2024/25 budget £m	2025/26 budget £m
External sources	82.4	129.6	19.1	3.5
Own resources:				
Capital receipts	13.0	6.4	2.9	2.8
Revenue / Reserves	5.50	0.1	0.1	0.1

S106/CIL	10.2	10.8	4.4	4.4
Debt	69.1	86.0	31.7	9.3
TOTAL	**180.2**	**233.0**	**58.2**	**20.1**

6. Updating the Strategy

The strategy in future years will monitor the savings are delivered. The Strategy must be approved by Council and submitted to the Secretary of State. A revised strategy may be replaced by another during the year with Council approval.

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Somerset County Council
Audit Committee
– 2nd February 2022

Minimum Revenue Provision Statement 2023/24

Lead Officer: Jason Vaughan, Director of Finance and Governance
Author: Donna Parham, Head of Corporate Finance and Deputy S151. Richard Bates Director of Finance, Mendip District Council
Executive Lead: Cllr Liz Leyshon, Deputy Leader and Lead Member Finance and HR
Division and Local Member: All

1. Summary

1.1. Where the Authority 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).

1.2. The Local Government Act 2003 requires the Authority to have regard to the Department for Levelling Up, Housing and Communities Government's Guidance on Minimum Revenue Provision (the DLUHC) most recently issued in 2018.

2. Issues for consideration / recommendations

2.1. The Committee is asked to review the Minimum Revenue Provision Statement 2023/24, whether there are any suggestions for amendments that they would like to recommend to the Executive.

3. Background

3.1. The statutory guidance requires the Authority to approve an MRP Statement each year and recommends several options for calculating a prudent amount of MRP.

3.2. The appendix attached sets out the principles of the calculation of MRP and the 2023/24 impact on the revenue budget. This has been a blended approach of policies across the District and the County authorities. The Director – Finance and Governance will review once the capital programme balances have transferred to the new Unitary Authority in 2023 and may wish to take a more streamlined approach next year.

4. Consultations undertaken

4.1. This statement has looked at the various approaches taken by each of the five Somerset authorities.

5. Implications

5.1. This statement is required under statutory legal guidance issued in Regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [as amended].

5.2. The financial implications of the statement directly impact the level of charge to the revenue budget and are included within the 2023/24 budget.

5.3. There are no specific HR implications arising from this report.

6. Background papers

6.1. None

Note For sight of individual background papers please contact the report authors

Minimum Revenue Provision (MRP) Policy Statement

1. 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 since 2008. The Local Government Act 2003 requires the Council to have regard to the Department for Levelling Up, Housing and Communities's Guidance on Minimum Revenue Provision (the DLUHC Guidance) most recently issued in 2018.

2. The broad aim of the Guidance is to ensure that capital expenditure is financed over a period that is reasonably commensurate with that over which the capital expenditure provides benefits.

3. The DLUHC Guidance requires the Council to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance as well as locally determined prudent methods.

4. Due to Local Government Re-organisation, 5 existing councils have merged to form the new Somerset Council from 1 April 2023. Past MRP charges made by each council will not be revisited but a consistent approach has been developed for the new Council from 1 April 2023.

5. For capital expenditure incurred before 1st April 2008, MRP will be determined in accordance with the former regulations that applied on 31st March 2008, incorporating an "Adjustment A" of £9.113m in relation to historic expenditure by South Somerset District Council and an "Adjustment A" of £0.785m in relation to historic expenditure by Sedgemoor District Council.

6. For capital expenditure on operational assets incurred between 31st March 2008 and 31st March 2023, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset by any of the following methods:
    a. In equal instalments, based upon asset life.
    b. In equal instalments based upon weighted average life where individual assets funded by borrowing are not known (note – SW&T to 31.3.2021= 45 years, SCC to 31.3.2021= 44 years)
    c. Using an annuity basis where appropriate (e.g. regeneration assets)

7. For capital expenditure on operational assets incurred post 31st March 2023, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset by either of the following methods:
    a. In equal instalments, based upon asset life
    b. Using an annuity basis where appropriate (e.g. regeneration assets)

8. For freehold land, MRP will be applied over 50 years, except where there is a structure on the land which the Council considers to have a life of more than 50 years where in such cases the longer life may also be applied to the land.

9. For capital expenditure not related to council assets but which has been capitalised by regulation or direction (e.g. capital grants to third parties) will be charged in equal instalments over a period of up to 25 years.

10. No MRP will be charged in respect of assets held within the Housing Revenue Account.

11. For assets acquired by leases, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

12. Where loans are made to other bodies for their capital expenditure, MRP will be charged in line with the repayment schedules. This would be reviewed and replaced by a prudent provision if it becomes apparent that the loan may not be repaid. This approach will be reviewed again for 2024-25 when the outcome of the consulation on MRP is confirmed.

13. For investment properties, MRP will be calculated over a period of no more than 50 years, and MRP may be calculated using an annuity basis. The basis used will be Option 3c. For existing investment properties, the 50 year term will be reduced by the period that the asset has already been held.

14. MRP will be charged from the start of the financial year after the expenditure is incurred, meaning capital expenditure incurred during 2023/24 will not be subject to a MRP charge until 2024/25.

15. Based on the Council's latest estimate of its capital financing requirement (CFR) on 31 March 2023, the budget estimate for MRP has been set as follows:

Capital Financing Requirement and MRP	31/03/2023 Estimated CFR £'000	2023-24 Estimated MRP £'000
Capital Finance Requirement at the end of 2022/23 and MRP payable in 2023/24	945.17	21.41

16. It is planned that Somerset County Council will make an additional payment of £3.7m in 2022/23 and each S151 Officer may determine such an overpayment during the year and report this through the Outturn Report.

Audit Committee Work Programme February - March 2023

2nd February 2023	SPECIAL MTFP	
MTFP reports	To review the Treasury and Non-Treasury Management Strategy, MRP Statement, Capital Strategy and Flexible Capital Receipts strategy	Jason Vaughan, Donna Parham
Audit committee TOR	Terms of reference for the new Somerset Council Audit committee	Jill Byron
16th February 2023	MEETING CANCELLED	
23rd March 2023		
Committee appointment report	Appointment of a second independent member of the audit committee	Jason Vaughan
Internal Audit Update from SWAP	Progress report from SWAP on the status of the current Internal Audit Plan, noting any high risks identified	Alastair Woodland SWAP
External Audit update	Update from Grant Thornton UK LLP on the work of the external auditors	Barrie Morris GT
Annual Report to Council	To approve the Committee's Annual report to Full Council	Jason Vaughan
Strategic Risk Management	The regular update on the Strategic Risk Register for SCC	Pam Pursley
LGR programme risks	The regular update on the Programme Risks for Local Government Reorganisation	Angela Farmer

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