APPENDIX A

Somerset West and Taunton Council

Capital, Investment and Treasury Strategies 2021/22 to 2025/26

Capital Strategy

1 Introduction

1.1 This Strategy document sets out Somerset West and Taunton Council's approach to capital investment. It provides an important framework and guiding principles that underpins its longer term capital investment plans, and forms part of the overarching corporate planning and financial strategy for the Council.

1.2 The Capital Strategy is part of the overarching financial governance framework, supporting strategic planning and financial strategy. It is included here together with closely related strategies in respect of investment and treasury management to provide a holistic view of capital, investment and borrowing requirements.

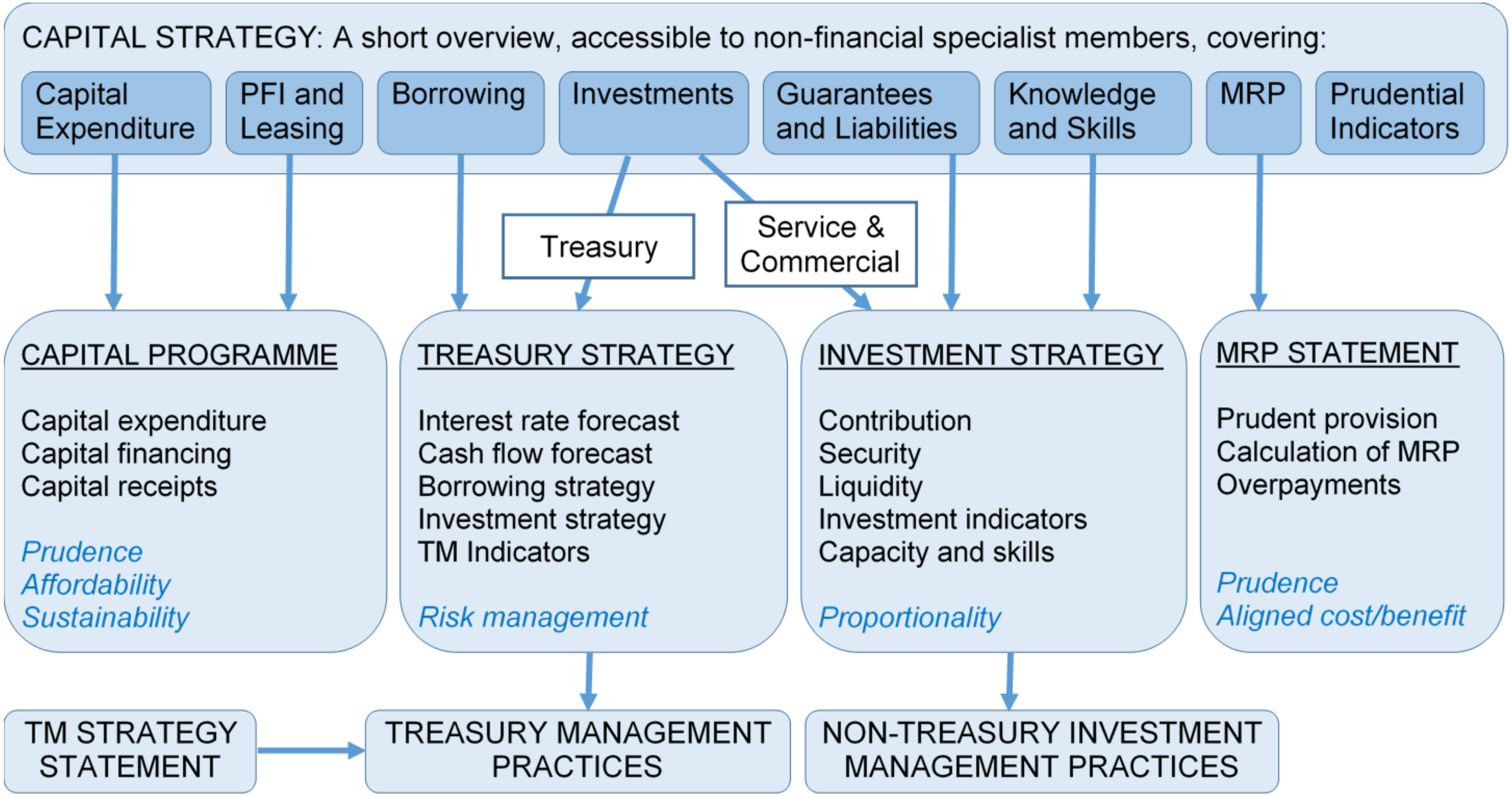
1.3 Somerset West and Taunton was created on 1 April 2019, with its assets, liabilities and functions transferred from the predecessor councils – Taunton Deane Borough Council and West Somerset District Council. Both Councils transferred a legacy borrowing requirement in respect of General Fund services which represented a small proportion of the value of capital assets transferred. In respect of Housing, TDBC transferred its Housing stock assets and associated borrowing requirement. Plans to meet the costs of the legacy borrowing requirement are embedded in both General Fund and Housing Revenue Account budgets and respective ongoing medium and long term financial plans.

1.4 SWT has plans that are expected to see a significant increase in capital investment both in the short term and longer term, related to housing, regeneration and commercial investment to generate income to fund local services and priority projects essential to the medium sustainability of the district. This will see growth in assets held on the balance sheet and a related growth in borrowing need. The Council actively pursues access to other sources of capital such as bids for government grant funding, and private sector investment where appropriate, and plans to utilise the majority of available New Homes Bonus income and Community Infrastructure Levy towards the Capital Programme.

1.5 The strategy for capital schemes, particular in respect of growth and regeneration schemes, will continue to focus on opportunities for capital investment that usually at least covers its costs within the District, and provides good potential for a sustainable, managed risk positive revenue benefit elsewhere. The details included in these Strategies and associated Tables reflect the position approved by the Council on 18 February 2021.

1.6 The Council also forecasts and plans to hold prudent investment balances that will meet short term cash flow requirements and provide an ongoing investment income through proportionate strategic investment in pooled funds.

1.7 The following diagram represents the Capital Strategy framework and how the capital, investment, treasury and MRP approaches interlink.



2 Capital Expenditure

Capital Expenditure Estimates

2.1 Capital expenditure is incurred where the Council spends money on constructing or acquiring assets such as land and buildings including housing, vehicles, plant and equipment, which will be used for more than one year, as well as larger scale maintenance works that maintain or enhance the Councils existing assets. In local government capital expenditure can also include spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Council has some limited discretion on what counts as capital expenditure. For example assets costing below £10,000 are not capitalised and are charged as revenue expenditure in the year. This discretion is reflected in the Council's accounting policies which are set out within the Statement of Accounts each year.

2.2 The information included in the table below shows the Council's actual capital spend in 2019/20, together with budgets and estimates for the financial years 2020/21 onwards:

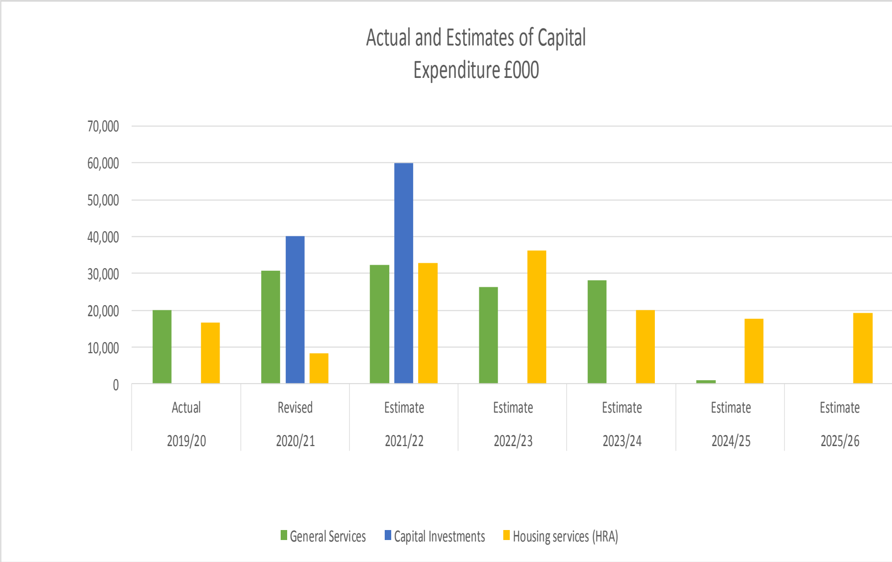
TABLE 1	**ACTUAL AND ESTIMATES OF CAPITAL EXPENDITURE**							
CAPITAL PROGRAMME	**2019/20 Actual £'000**	**2020/21 Revised £'000**	**2021/22 Estimate £'000**	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**	**2024/25 Estimate £'000**	**2025/26 Estimate £'000**	**2020/26 Totals £'000**
General Services	20,073	30,670	32,202	26,315	28,230	1,000	0	118,416
Capital Investments	0	40,000	60,000	0	0	0	0	100,000
Housing services (HRA)	16,687	8,261	32,733	36,332	20,137	17,640	19,373	134,475
Totals	**36,760**	**78,931**	**124,935**	**62,646**	**48,367**	**18,640**	**19,373**	**352,891**

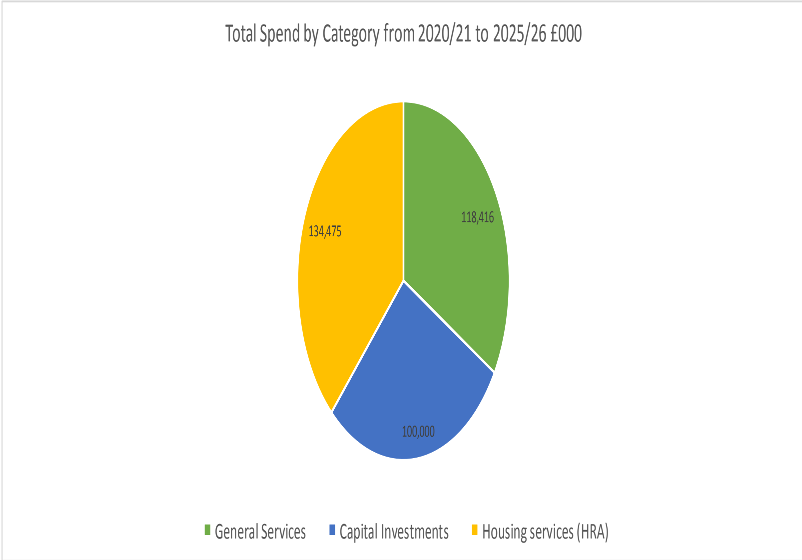
2.3 The Council's capital investment focuses on the following main areas:

- Investment in new and existing operational assets and issuing capital grants to support the delivery of its services and strategic priorities. This includes schemes such as technology, regeneration and infrastructure projects, contributions to major transport and flood alleviation projects, and grants for accessibility adaptations and equipment to support independent living.
- Investment to balance and complete the Council's commercial investment income portfolio in 2021/22, as set out in the investment strategy. This may include direct property freehold or long-leasehold acquisition, as well as shareholdings and loans to third parties and subsidiaries.

- Investment in the Council's own housing provision by acquiring, building and improving its housing stock. This includes schemes such as the North Taunton housing regeneration programme, annual programme of additions to stock to deliver vital affordable housing in the district, and major works to maintain and improve our decent homes standards across the portfolio. This investment is funded through the Housing Revenue Account.

2.4 The Housing Revenue Account (HRA) is a ring-fenced account which ensures that council housing does not subsidise, or is itself subsidised by, Council taxpayers. HRA capital expenditure is therefore recorded separately. The following charts provide an overview of the main areas of investment.





Capital Programme

2.5 The Capital Programme represents the Council's commitment to continue to invest in its operational asset portfolio and wider investment to support housing, economy and place-shaping priorities. It is reviewed annually and approved through the budget setting process, taking into account the availability of capital resources and the financing cost implications on the revenue budget.

2.6 New capital schemes and projects are usually added to the Programme as part of the annual process. However, the Council's governance arrangements allow for new schemes and projects to be added or removed from the programme during the year subject to appropriate approvals.

2.7 The annual programme is developed where managers bid in September/October for projects to be considered, with an outline scheme appraisal and specific funding proposals where appropriate. Bids are collated by Finance to summarise the potential expenditure requirement and assess the capital financing options. The programme is also informed by the Council's Asset Management Strategy and Plan, as well as strategic organisational development and improvement programmes.

2.8 The draft programme is presented initially to the Leadership team – Senior Officers and Executive Councillors, and priority proposals are then taken forward to Scrutiny Committee for review and comment. The Executive then considered and recommended the final draft Capital Programme to Full Council, which was approved in February 2021.

2.9 The approved capital programme includes investment of £40.0m in 2020/21, with a further investment of £60.0m in the subsequent year 2021/22.

Asset Management

2.10 Asset Management falls within the responsibilities of the External Operations and Climate Change Directorate. The Council also manages investment property assets through the Commercial Investment Team within the Development and Place Directorate, with access to the Council's internal specialists and appointed managing agents as appropriate.

2.11 The Council has a core team of qualified property professionals who advise on acquisitions, disposals and day to day management of all Council assets.

2.12 The refreshed Asset Management Plan for the Council's (non-Commercial Investment) Property Assets requires a review of three critical areas: service need, holding expenses and any income or revenue accruing. This process now has a clear direction with the engagement of an additional resource to Project Manage collation of cost data and a 30 year investment and divestment programme.

2.13 A necessary element in the review is the identification of a suitable database application which will hold audited property data and enable real time analysis and reporting, and we are engaging with internal groups and partner organisations in this respect. Once robust costs and trends are available, these will be applied to income projections and a cost-benefit analysis run to inform operational options and make recommendations.

2.14 During the time period of the project to collate all the inputs, in accordance with the scheme of delegations the Assets Team will continue to proactively manage the Council's property portfolio and make recommendations to the SMT, Executive, and Council both at a strategic level and as part of day to day business as usual. The Investment Properties portfolio is managed in line with the Commercial Investment Property Strategy governance arrangements with decisions on acquisition and disposal agreed via the Investment Board or Full Council if above £25m for acquisitions or above £30m for disposals.

2.15 The assets already within the Council's ownership are actively managed on a day to day basis in order to minimise costs and risks and to maximise any receipts. An important aspect will be the identification of expenses and receipts to specific property assets to enable non-performing investments or properties with excessive costs to be identified and considered for disposal.

2.16 Properties considered for acquisition within the Corporate Investment Strategy are thoroughly reviewed, financial models run and due diligence undertaken. Potential acquisitions which meet the initial criteria are then presented to the Investment Panel and Investment Board for authorisation.

2.17 Assets acquired as part of the Commercial Property Investment Strategy are managed internally or outsourced to local specialists, depending on the circumstances.

3 Capital Financing

3.1 The Council's capital investment falls within the scope of the CIPFA Prudential Code for Capital Finance in Local Authorities (the 'Prudential Code'), to which the Council must give due regard. Under the Prudential Code the Council has discretion over the funding of capital expenditure and the freedom to determine the level of borrowing it undertakes to deliver the Capital Programme.

3.2 The accounting practices used follow the guidance provided in 'The Prudential Code for Capital Finance in Local Authorities: Guidance Notes for Practitioners 2018' and The Practitioners Guide to Capital Finance in Local Government 2019.

3.3 All capital expenditure must be financed, and there are range of potential funding sources the Council may use including its own resources or externally:

- Capital receipts from asset disposals and loan repayments;
- Capital grants e.g. from Government or other local authorities;
- Contributions from others e.g. Section 106 (S106) and Community Infrastructure Levy (CIL);
- Revenue Contributions to Capital e.g. from the Revenue Budget or Revenue Reserves; and

➢ Debt financing e.g. borrowing, capital market bonds, leasing.

Capital Financing Plan

3.4 The planned financing of the capital expenditure is shown below and in Table 2, as follows:

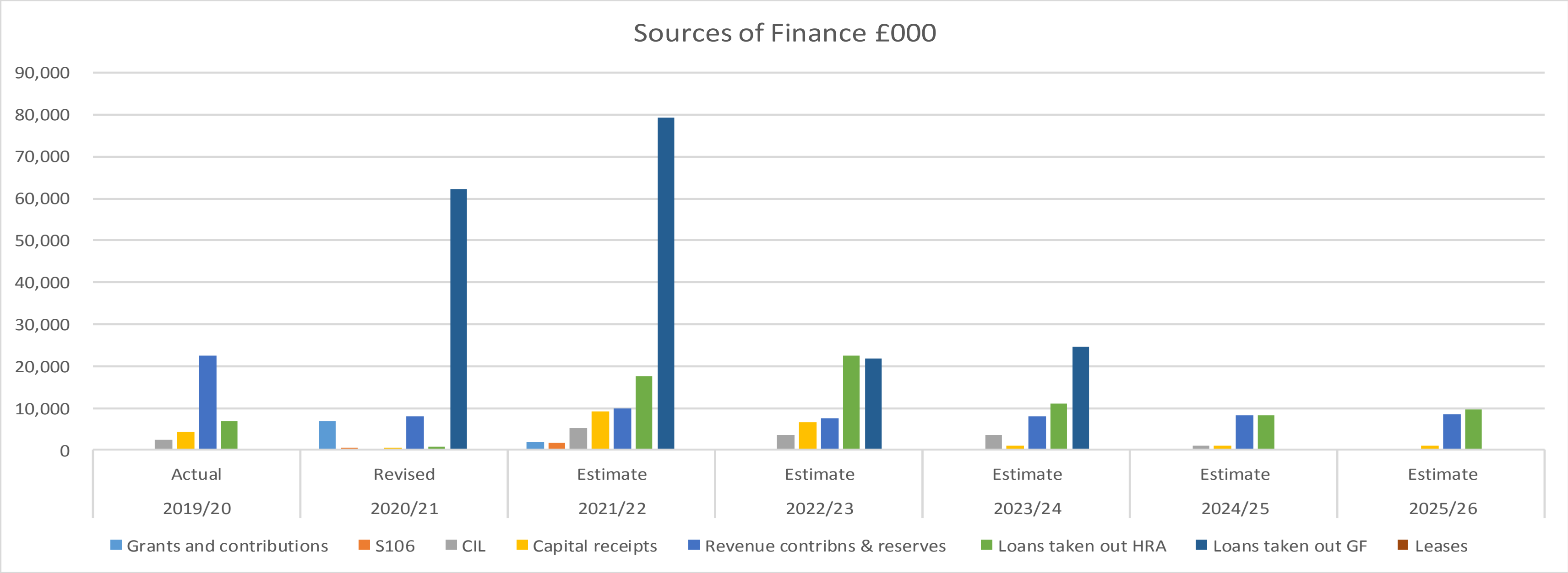


TABLE 2	CAPITAL FINANCING PLAN							
	2019/20 Actual £'000	**2020/21 Revised £'000**	**2021/22 Estimate £'000**	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**	**2024/25 Estimate £'000**	**2025/26 Estimate £'000**	**2020/26 Totals £'000**
External sources:								
Grants and contributions	374	6,858	2,018	400	0	0	0	9,275
S106	282	468	1,638	0	208	0	0	2,314
CIL	2,501	0	5,262	3,500	3,500	1,000	0	13,262
subtotal - External	**3,157**	**7,325**	**8,918**	**3,900**	**3,708**	**1,000**	**0**	**24,851**
Internal sources:								
Capital receipts	4,408	590	9,133	6,763	1,076	1,002	1,095	19,659
Revenue contribns & reserves	22,420	8,004	9,969	7,642	7,942	8,242	8,542	50,341
subtotal - Internal	**26,828**	**8,594**	**19,102**	**14,405**	**9,018**	**9,244**	**9,637**	**70,001**
Debt								
Loans taken out HRA	6,775	833	17,684	22,449	11,118	8,395	9,736	70,215
Loans taken out GF	0	62,178	79,231	21,892	24,522	0	0	187,824
Loans taken out subtotal	6,775	63,011	96,915	44,342	35,640	8,395	9,736	258,039
Leases	0	0	0	0	0	0	0	0
subtotal - Debt	**6,775**	**63,011**	**96,915**	**44,342**	**35,640**	**8,395**	**9,736**	**258,039**
TOTAL	**36,760**	**78,931**	**124,935**	**62,646**	**48,367**	**18,640**	**19,373**	**352,891**

3.5 The allocation of resources may vary over time, for example, where additional income is achieved through asset sales or obtaining external funding. The plan is therefore dynamic, and is overseen by the Council's S151 Officer to optimise financing arrangements on an ongoing basis. The estimates will not commit the Council to particular methods of financing. The S151 Officer will determine the actual financing of capital expenditure incurred at the end of the financial year.

3.6 The implications of financing capital expenditure from borrowing is that the expenditure is not funded immediately but charged to the revenue budget over a number of years. The Council may defer the timing of external borrowing on a short to medium term by using temporary cash resources held in reserves and balances. This practice, which is referred to as 'internal borrowing', does not reduce the magnitude of borrowing required or the level of funds held in reserves and balances; the funds are merely being utilised in the short term until they are required for their intended purpose. The timing of external borrowing and the balance of external / internal borrowing is determined by market conditions and the Council's cash flow position. Officers manage this position on a day to day basis in line with the overall Treasury Management Strategy.

3.7 Debt in the form of loans and leases must be repaid. This occurs over time by financing, usually from revenue, and the minimum revenue provision (MRP) or from additional voluntary revenue provision (VRP). Alternatively, capital receipts may be used to replace debt finance.

Capital Financing Requirement

3.8 The Council's cumulative amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP repayments and capital receipts used to replace debt. Based on the above figures for expenditure and financing the Council's estimated CFR is shown below and in Table 3:

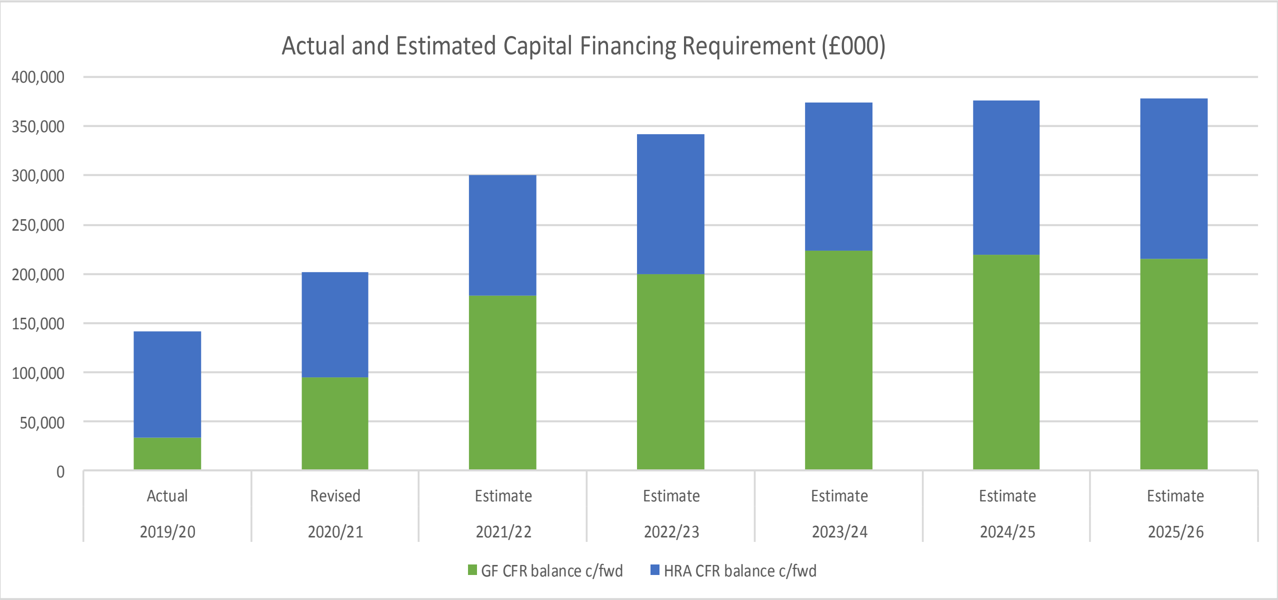


TABLE 3	PRUDENTIAL INDICATOR ACTUAL AND ESTIMATED CAPITAL FINANCING REQUIREMENT						
	2019/20 Actual £'000	2020/21 Revised £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
General Fund							
CFR balance b/fwd	20,455	33,944	95,422	177,948	199,671	223,577	219,967
Expenditure	20,073	70,670	92,202	26,315	28,230	1,000	0
MRP/VRP	(799)	(700)	(1,967)	(3,669)	(4,117)	(4,610)	(4,535)
Capital receipts used	(123)	(590)	(3,553)	(522)	0	0	0
Grants and contributions	(5,662)	(7,901)	(4,155)	(400)	(208)	0	0
Accounting adj - Leases	0	0	0	0	0	0	0
GF CFR balance c/fwd	**33,944**	**95,422**	**177,948**	**199,671**	**223,577**	**219,967**	**215,431**
HRA							
CFR balance b/fwd	103,028	107,982	106,225	122,507	142,510	150,850	156,327
Expenditure	16,687	8,261	32,733	36,332	20,137	17,640	19,373
MRP/VRP	(1,821)	(1,904)	(1,874)	(2,146)	(2,479)	(2,618)	(2,709)
Capital receipts used	(3,074)	0	(6,936)	(6,240)	(1,076)	(1,002)	(1,095)
Grants and contributions	(6,838)	(8,114)	(7,642)	(7,942)	(8,242)	(8,542)	(8,842)
Accounting adj - Leases	0	0	0	0	0	0	0
HRA CFR balance c/fwd	**107,982**	**106,225**	**122,507**	**142,510**	**150,850**	**156,327**	**163,053**
TOTAL CFR balance c/fwd	**141,926**	**201,648**	**300,455**	**342,182**	**374,426**	**376,294**	**378,485**

3.9 The chart and Table 3 show that the Council's proposed capital strategy and capital investment plans are expected to increase the overall indebtedness position of the next 5 years. It is important to ensure such plans are affordable and the Council can meet the costs of this debt over the short and long term. This strategy considers affordability through a range of measures, for example, in respect of the Housing Revenue Account debt-financed expenditure we have introduced an interest cover ratio (ICR) benchmark of 1.25 to ensure borrowing costs are affordable. Other measures are shown within the prudential indicators in the Treasury Management Strategy section of this report.

Grants and Contributions

3.10 The Council will seek to access external funding towards its capital investment plans where funds are available and our schemes are within scope. Examples of grants may include Government schemes such Housing Infrastructure Fund, Future High Streets Fund and so on. We also receive contributions from other bodies such as developers in the form of S106 planning obligations contributions and Community Infrastructure Levy (see below). It is often the case that the Council will need to put some of its own resources towards a scheme in order to attract the external funding. This can be effective in levering in funds to enable larger infrastructure investments to progress.

3.11 The balance of capital grants unapplied held by SWT on 31 March 2020 was £9.583m. Of this sum, £6.935mm is committed to financing the current approved Capital Programme. Bids are usually a competitive process therefore expenditure is usually only built into the approved capital programme once the funding has been confirmed.

S106

3.12 S106 contributions are agreed as contributions towards certain obligations through planning approvals. Contributions that related to district council services within SWT are paid to the Council, and are usually restricted on the nature of costs that the funds can be used for, such as public art, play areas and equipment, affordable housing provision. S106 can be used to fund both revenue and capital costs and therefore allocated to capital and revenue budgets accordingly.

3.13 Under the planning agreement for the development of Hinkley Point C nuclear power station, significant mitigation funds have been paid by EDF to the Council as the planning authority. These S106 funds are used to contribute to enhanced service costs and can also be used for capital projects.

3.14 Decisions regarding the allocation of funds may be taken by the relevant budget holder for the expenditure for amounts up to £20k, by Director/CEO and S151 Officer up to £50k and Portfolio Holder and S151 Officer above £50k. Proposals for the allocation of funds to specific projects are considered by the Planning Obligations Board, who will make recommendations to the Executive for schemes up to £250k, and by Full Council for larger schemes. The governance arrangements are currently being reviewed for the ongoing management of S106 funds.

Community Infrastructure Levy (CIL)

3.15 The Council operates an approved CIL policy, with the levy payable on development in certain areas within the District. CIL is recognised as capital income and therefore provides resources to contribute to eligible infrastructure investment such as transport/roads, education, town centre regeneration and flood alleviation schemes. 15% (or 25% with an adopted Neighbourhood Plan) of CIL income is passed to town or parish councils, and 5% is allocated to fund administration costs.

3.16 The Policy is approved by Council and implemented by Officers. Council determines the allocation of CIL income to investment themes as part of the annual capital programme approval process. The Executive Committee or Portfolio Holder for Asset Management and Economic Development may agree specific scheme allocations for projects >£250k, or the Director of External Operations and Climate Change for projects <£250k, within the limits allocated by Council to each theme. Expenditure to be funded by CIL is only committed once CIL income has actually been received.

TABLE 4	**Estimated CIL Retained Income (Net of town/parish share and administration costs)**						
	2019/20 Actual £'000	**2020/21 Revised £'000**	**2021/22 Estimate £'000**	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**	**2024/25 Estimate £'000**	**2025/26 Estimate £'000**
Net CIL income	**2,501**	**0**	**5,262**	**3,500**	**3,500**	**1,000**	**0**

Capital Receipts

3.17 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 income.

3.18 The Council estimates it will receive £27.621m of capital receipts in the period 2020/21 to 2025/26 as set out below.

TABLE 5	Capital receipts income estimates						
	2019/20 Actual £'000	**2020/21 Revised £'000**	**2021/22 Estimate £'000**	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**	**2024/25 Estimate £'000**	**2025/26 Estimate £'000**
General Fund:							
Asset Disposals	635	590	3,553	522	0	0	0
Loans and Grants repaid	2,562	882	1,228	1,300	1,500	1,300	396
Other	0	0	0	0	0	0	0
General Fund Total	**3,197**	**1,472**	**4,781**	**1,822**	**1,500**	**1,300**	**396**
HRA:							
Right to buy sales	4,264	0	5,580	6,240	1,076	1,002	1,095
Other	0	0	1,356	0	0	0	0
HRA Total	**4,264**	**0**	**6,936**	**6,240**	**1,076**	**1,002**	**1,095**
Total Receipts	**7,461**	**1,472**	**11,717**	**8,063**	**2,576**	**2,302**	**1,491**

3.19 The generation of capital receipts will be driven in part by the Asset Management Strategy, where the Council proposes a programme of proactive disposal of assets that are not performing to an acceptable level or are identified as surplus to requirements.

Flexible Use of Capital Receipts

3.20 Since the Spending Review 2015, the government has allowed local authorities to spend up to 100% of their capital receipts from the sale of non-housing assets on revenue costs incurred for transformation i.e. to generate ongoing revenue savings, to reduce costs and / or transform service delivery in a way that reduces costs or demand for services in future years. This flexibility ends in 2021/22.

3.21 TDBC and WSC previously used this scheme and as part of the new Council's updated strategy it was proposed to revise this plan to use £2.200m for the whole 6 year period to 2021/22. For the period up to 31 March 2020, £1.840m was used to fund eligible costs, and an additional £0.360m is available to be used up to March 2022 as shown below. This has been included in the Capital Programme to Council on 18 February 2021 as Resources for Change Programme.

TABLE 6	Flexible use of Capital receipts						
	2019/20 Actual £'000	2020/21 Revised £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
General Fund	180	108	252	n/a	n/a	n/a	n/a
HRA	0	0	0	n/a	n/a	n/a	n/a
Total Flexible use of capital receipts	180	108	252	n/a	n/a	n/a	n/a

Revenue Contributions to Capital

3.22 The Council proposes to support the financing of part of the Capital Programme through direct contributions of revenue funding. Annual contributions are determined through the setting of Capital Programme priorities and affordability within the Revenue Budget. Revenue contributions are predominantly directed towards recurring annual investments, with the advantage of reducing debt financing costs. Revenue Contributions are included in the Revenue MTFP and the Capital Programme financing plan, as summarised in Table 2 above.

4 Treasury Management and Borrowing Strategy

4.1 Treasury management is concerned with 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. The Council is typically cash rich in the short-term as revenue is earned before it is spent but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing need.

4.2 Due to previous spending and financing decisions within the Council's predecessor authorities, £79.1m of external borrowing was transferred to the Council on 1 April 2019. At the end of 2019/20, the total of long term borrowing was £75.6m.

4.3 The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in the future. In addition, appropriate flexibility on loan durations is planned to be maintained to reflect the potential flexible nature of planned investment in regeneration. These objectives are often conflicting and the Council, therefore, seeks to strike a balance between cheaper short-term loans (currently available at around 0.1%-0.5%) and long term fixed rate loans where the future cost is known but higher (currently 1%-3%).

4.4 Council's do not borrow for specific assets and cannot use local authority assets as security. Borrowing is undertaken to meet the capital financing requirement as a whole (less any short term use of temporary cash balances).

Public Works Loans Board (PWLB)

4.5 A common source of borrowing for local authorities is the Treasury, through the Debt Management Office, which took over the responsibilities of the previous Public Works Loans Board (although the term PWLB is still commonly used). There are a number of advantages to using the PWLB as a source of borrowing, such as

- Funds can be accessed quickly – usually within 2-3 days of notice;
- It is simple to arrange with limited time and effort required;
- The Council does not require a credit rating; and
- Borrowing is not linked to any specific asset, but can provide the resources need to meet the overall capital financing requirement.

4.6 In order to discourage borrowing for property assets primarily for yield, the government issued a revised procedure for accessing PWLB loans in November 2020. This reduced the cost of loans but also demanded a commitment from the borrowing Council's Chief Financial Officer that there would be no use of PWLB funds towards property assets primarily for yield for the current year and following two years. The Council therefore used shorter term, non PWLB debt to facilitate completion of a commercial development in December 2020, and honoured a negotiated commitment that was not legally binding in order to maintain the Council's reputation. On this basis the PWLB is not expected to be available to finance new capital expenditure at least until March 2023 and possibly longer depending on future capital expenditure plans.

4.7 Guidance from HM Treasury indicates that PWLB may still be used to refinance historic borrowing even if the Council is actively investing in property assets primarily for yield. This is likely to be a preferable treasury option, for example regarding existing HRA loans that mature over the next 10 years that will need to be refinanced to meet the current HRA Business Plan.

Total Debt Position

4.8 Projected levels of the Council's total outstanding external debt are shown below, compared with the CFR (as detailed above in Table 3). Statutory guidance is that actual debt should not exceed the CFR, except in the short-term. As can be seen from the Table the Council expects to comply with this in the medium term.

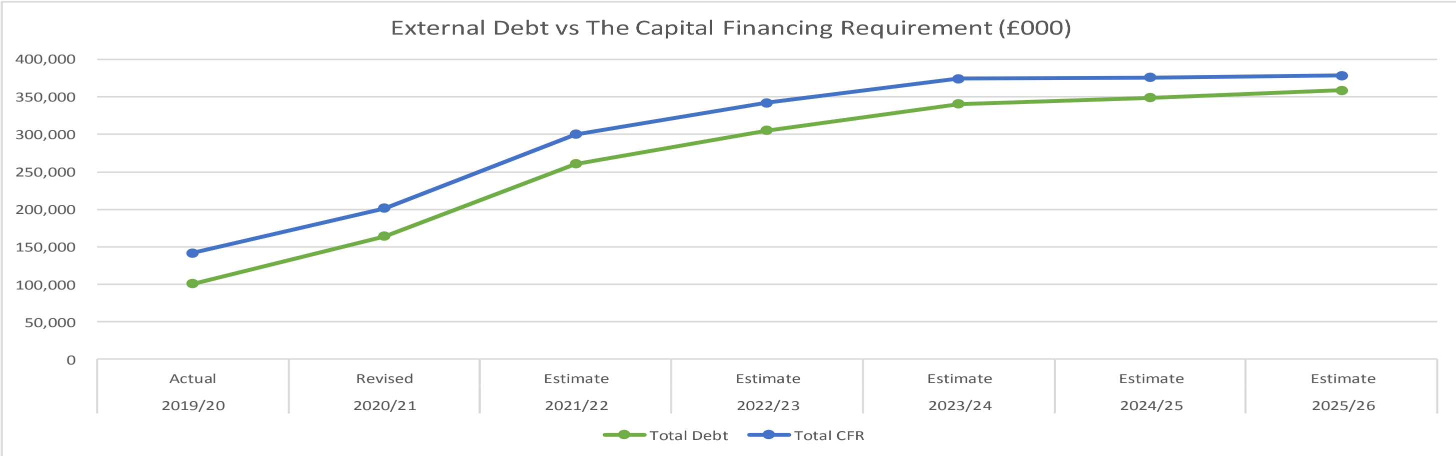


TABLE 7	Prudential indicator - Gross debt and the CFR						
	2019/20 Actual £'000	2020/21 Revised £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
General Fund debt	25,500	87,678	166,909	188,802	213,324	213,324	213,324
HRA debt	75,500	76,333	94,017	116,466	127,584	135,980	145,715
Total Debt	**101,000**	**164,011**	**260,926**	**305,268**	**340,908**	**349,303**	**359,039**
General Fund CFR	33,944	95,422	177,948	199,671	223,577	219,967	215,431
HRA CFR	107,982	106,225	122,507	142,510	150,850	156,327	163,053
Total CFR	**141,926**	**201,648**	**300,455**	**342,182**	**374,426**	**376,294**	**378,485**

4.9 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 that cash and investment balances are kept to a minimum level of £30.0m at each year-end. This benchmark is anticipated to be £151.8m at the start of 2021/22 and is forecast to rise to a maximum of £341.6m over the next five years.

TABLE 8	**Actual borrowing and the Liability Benchmark**						
	2019/20 Actual £'000	**2020/21 Revised £'000**	**2021/22 Estimate £'000**	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**	**2024/25 Estimate £'000**	**2025/26 Estimate £'000**
External Borrowing Outstanding	101,000	164,011	260,926	305,268	340,908	349,303	359,039
CFR	141,926	201,648	300,455	342,182	374,426	376,294	378,485
Less: Usable reserves	(60,530)	(44,570)	(32,889)	(31,639)	(31,639)	(31,639)	(31,639)
Less: Working capital	(19,531)	(24,300)	(24,300)	(24,300)	(24,300)	(24,300)	(24,300)
Plus: Minimum investments	13,026	19,000	17,000	17,000	19,000	19,000	19,000
Liability benchmark	**74,891**	**151,778**	**260,266**	**303,243**	**337,487**	**339,355**	**341,546**

4.10 The table shows that the Council expects to borrow above its liability benchmark throughout the five year period. This is because deliberate decisions has been made to borrow additional sums, across the periods for continuing investment in housing stock, and initially for completion of the commercial investments. Further detail on the liability benchmark is included in the Treasury Management Strategy below.

Affordable Borrowing Limit

4.11 The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach this limit. The Operational Boundary has been calculated based on the forecast CFR plus a tolerance for variations in spending plans during the year and possible volatility in availability of internal and external resources.

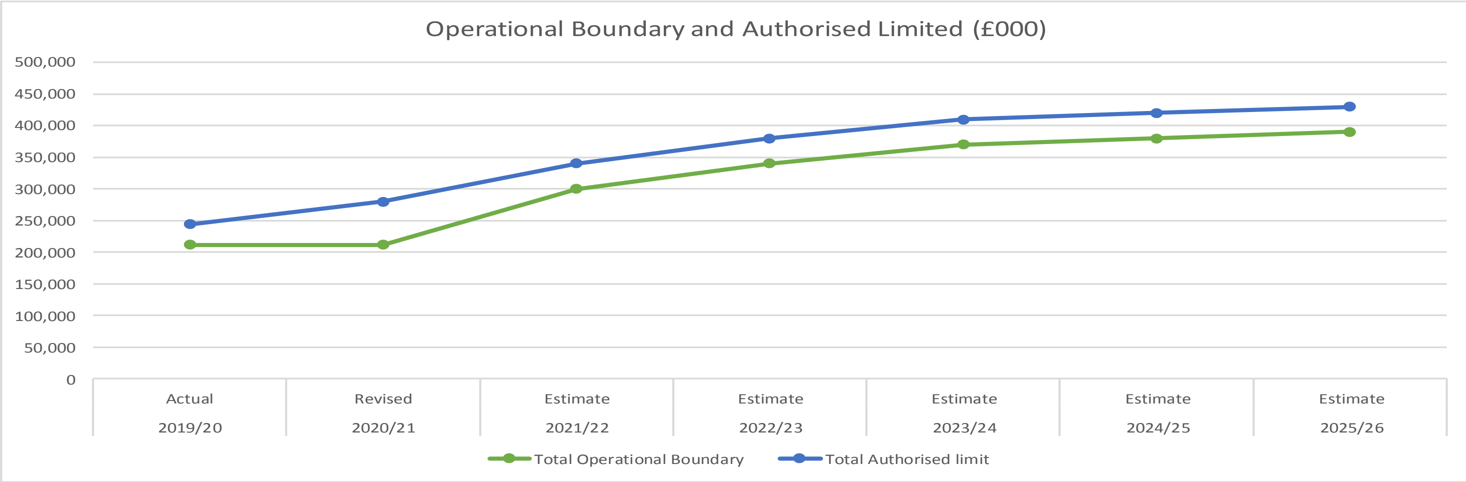


TABLE 9	Authorised limit and Operational boundary for external debt						
	2019/20 Actual £'000	2020/21 Revised £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
Operational Boundary:							
Borrowing	212,000	212,000	300,000	340,000	370,000	380,000	390,000
Leases							
Total Operational Boundary	**212,000**	**212,000**	**300,000**	**340,000**	**370,000**	**380,000**	**390,000**
Authorised limit:							
Borrowing	244,000	280,000	340,000	380,000	410,000	420,000	430,000
Leases							
Total Authorised limit	**244,000**	**280,000**	**340,000**	**380,000**	**410,000**	**420,000**	**430,000**
Note - indicative limits for:							
General Fund	128,000	125,000	190,000	210,000	230,000	230,000	230,000
HRA	116,000	155,000	150,000	170,000	180,000	190,000	200,000

4.12 The total borrowing limit applies to the combined borrowing requirement for the General Fund and the Housing Revenue Account. As borrowing is managed on a pooled basis for cash flow purposes the above limits relate to the whole-Council position. However, indicative splits between the GF and HRA are included as a memorandum item although not specifically required for the prudential indicator.

4.13 Although borrowing is expected to grow, this is regarded as affordable on the basis that the majority of the costs of debt are offset by income growth within the Council's financial strategy, either through return on investment in property – which provides a surplus after financing to fund services, through investment in regeneration schemes which also generate income, or through service loans which will be repaid.

4.14 Further details of existing borrowing can be found in the Treasury Management Strategy Statement.

5 Investment Strategy

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

5.2 The Council's policy on treasury investments is to prioritise security and liquidity over yield, therefore to focus on minimising risk rather than maximising returns. 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, including in bonds, shares and property, 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.

5.3 As part of the Council's financial strategy, the aim is to evolve the balance within the investment portfolio to improve the net income available through treasury management to fund services, whilst maintaining a prudent balance between security, liquidity and yield. The yield curve has reduced in the last 12 months to such an extent that returns through long term treasury investment are minimal. It is therefore anticipated that investment will remain in the near term, maximising security and liquidity/ flexibility. The assessment of adequate general reserves also incorporates an element of risk to investment income assumptions.

TABLE 10	Treasury Management Investments						
	2019/20 Actual £'000	**2020/21 Revised £'000**	**2021/22 Estimate £'000**	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**	**2024/25 Estimate £'000**	**2025/26 Estimate £'000**
Near term investments	13,026	19,000	17,000	17,000	19,000	19,000	19,000
Long term investments	3	0	0	0	0	0	0
Total	**13,029**	**19,000**	**17,000**	**17,000**	**19,000**	**19,000**	**19,000**

5.4 Further details of existing treasury investments can be found in the Treasury Management Strategy below.

5.5 The effective management and control of risk are prime objectives of the Council's treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives may be used to manage treasury risks.

5.6 Decisions on treasury management and borrowing are made daily and are, therefore, delegated to the s151 Officer and his staff who must act in line with the Treasury Management Strategy approved by Full Council. Reports on treasury management activities are presented to the Audit Governance and Standards Committee mid-year and at year-end.

Investment for Service Purposes

5.7 The Council makes investments to assist local public services, including making loans to local small businesses to promote economic growth. Examples of current loans are included in Section 3 of the Investment Strategy below.

5.8 In light of the public service objective, the Council is willing to take more risk than with treasury investments, however, it still plans for such investments to generate a positive investment return after all costs are covered.

5.9 Decisions on service investments are made by the relevant service manager in consultation with the s151 officer and must meet the criteria and limits laid down in the investment strategy. Most loans are capital expenditure and purchases will, therefore, also be approved by Committee or through delegated powers as part of the capital programme.

Investment and Regeneration Activities

5.10 Local authorities have a key role in facilitating the long term regeneration and economic growth of their local areas and they may wish to hold investments to facilitate this. When determining whether to acquire, the Council needs to recognise the contribution the asset will make. The contribution could be classified as direct service delivery and/or place-making, for example economic growth, business rates growth, responding to market failure or sustainability of certain asset classifications. Further details of the Council's four regeneration schemes are contained in Section 6 of the Investment Strategy.

5.11 On 1 April 2020, investment properties and land valued at £6.763m were held by SWTC, which generated a gross yield of £0.525m in 2019/20. There was significant re-categorisation in 2019/20 from investment properties to other land and buildings (operational properties) which potentially distorted the net yield position.

5.12 The Council has agreed to complete its planned commercial investment activity in 2020/21 and 2021/22 to help mitigate the reduction in central government financial support and avoid cuts to local services. With financial return being the main objective, the Council accepts higher risk on commercial investment than with treasury investments. The priorities for the Council when acquiring property interests for investment purposes are detailed below and each property will be assessed on a case by case basis:

- Covenant strength: In the case of a let property, the quality of the tenant and, more importantly, their ability to pay the rent on time and in full. The Council's primary reason and objective for this strategy is financial gain. The underlying principles of a Property Investment Strategy imply, assume and default to nothing taking higher priority than financial gain. It is however worth noting that the Council, as a public body, may not wish to invest in properties where the occupiers are generally seen to be undertaking a business which is contrary to its corporate values.
- Lease length: In the case of a let property, the unexpired length of the term of the lease or a tenant's break clause is of key importance in ensuring that the landlord's revenue stream is uninterrupted. The Council will take into consideration the risks associated with a tenant vacating and the potential to attract good quality replacement tenants at acceptable rental levels. Generally occupiers are moving away from 25 year leases which were more common back in the late twentieth century with 10 to 15 years or shorter now becoming more acceptable unless some form of lease break provisions are included in favour of the tenant.
- Rate of Return: The rate of return from the property (for example through annual rental incomes) will need to be equivalent or better to the returns that could be earned from alternate investments, such as placing monies on

deposit, following adjustment for risks and potential growth. The property will also need to produce an annual return in excess of the cost of borrowing.

- Risk: Rate of return is one side of the coin; risk is the other. In general, the higher the sought level of return from an investment, the higher level of risk that it carries. For example, if a property is let at an attractive rent which would create a good return, it could still be risky if the tenant does not possess good covenant strength and could default at any time.
- Lease terms: The terms of leases vary and even those held on an “Institutionally acceptable basis” can be very different in nature particularly as such leases have developed over time. The Council is seeking to invest in modern leases with full repairing and insuring obligations on the Tenant and a full Service Charge recovery to include any management fees where applicable. This will ensure a certain income/return to the Council.
- Growth: Property has the potential for both revenue and capital growth. The Council will take into account that potential when assessing the strength of the investment opportunity. Property values can fall as well as rise and mechanisms to minimise revenue reductions should be identified. Generally the nature of standard, institutional leases is that rent review clauses are upward only which protects landlords from any downward pressure on rental income giving some security as to the level of income.
- Location: Should a tenant default or vacate, the location of the property is the key factor in influencing the ability to re-let and find another tenant. Location is also important when considering future redevelopment or regeneration opportunities. Ideally the Council will be able to undertake inspections and to deal with any management issues without the need to employ specialists or agents. Preference should be given to properties located within the district or functional economic area. This does not prevent investment outside of district, subject to the appropriate justification and business case and correct governance procedure. Equally, geographical diversification is an important factor in spreading portfolio risk.
- Sector: Information as to the sector of use of the property (e.g. office, retail, industrial, leisure) will assist in deciding on the risks associated with specific properties and the mix of sectors within the portfolio. Sector diversification is an important factor in spreading portfolio risk.
- Property age and specification: In the case of a let property, whilst the Council as an investor may be principally concerned with the characteristics of the tenant and lease, the age and specification of the property will also affect the ability of the Council to let or sell the property in the future. It must also be taken into consideration in respect of the cost of protecting the investment. An example of this would be the undertaking of repairs and refurbishment if the cost cannot be fully recovered from the tenant.

5.13 In summary the strategy for acquiring and managing the portfolio of investment property assets is therefore to:

a. Seek property let to tenants who are of strong covenant strength and sound financial standing with at least more than five years remaining on an FRI lease;
b. Manage risk;
c. Optimise rental income and management costs to ensure the best return is generated, thus making a positive contribution to the MTFP;
d. Prioritise key towns in Somerset West and Taunton where this complements the portfolio risk balance; and
e. Identify opportunities for future growth, redevelopment or regeneration via property in commercially popular or development areas, pursuing a geographical mix within the region to spread risk.

5.14 Environmental, Social and Governance (ESG) considerations - the Council has declared a policy objective of no direct investment in fracking, and seeking investment that does not conflict with its climate change priority. The aim is therefore to consider the Council's principles and priorities around ethics, social value and the environment as part of the investment decision process.

5.15 Decisions on commercial investments are delegated by the Council to the Investment Board in line with the criteria and limits approved by Full Council in December 2019, and refreshed in December 2020. Property and most other commercial investments are also capital expenditure and purchases will therefore be reported as part of the capital programme. Performance of the investment portfolio will be reported to the Executive and also be incorporated within the overall financial monitoring reports throughout the year.

5.16 Further details on commercial investments and limits on their use are set out in Section 5 of the Investment Strategy.

6 Liabilities

6.1 In addition to capital debt as detailed above the Council is committed to making future payments to cover its pension deficit, which was valued at £111.9m on 31 March 2020. This balance is due to be paid over a 20 year period, and the deficit and annual contributions are revalued every three years. It has also set aside £0.945m to cover provisions for probable costs. The Council is also at risk of having to pay for contingent liabilities but has not put aside any money because payment is contingent on, as yet, unknown events occurring which may crystallise possible amounts due.

6.2 Decisions on incurring new discretionary liabilities are taken by senior managers and service managers in consultation with the s151 Officer. The risk of liabilities crystallising and requiring payment is monitored by the finance team and reported to the s151 Officer.

6.3 Further details on liabilities and guarantees can be found in the 2019/20 Statement of Accounts for Somerset West and Taunton Council.

7 Revenue Budget Implications

7.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans/leases and capital debt repayment provisions 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 11	**Proportion of financing costs to revenue stream**						
	2019/20 Actual £'000	**2020/21 Revised £'000**	**2021/22 Estimate £'000**	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**	**2024/25 Estimate £'000**	**2025/26 Estimate £'000**
Financing costs - General Fund	(21)	39	1,766	3,335	3,786	4,272	4,191
Proportion of net revenue stream	0.1%	0.2%	9.4%	22.8%	26.7%	28.6%	27.4%

7.2 Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The S151 Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable. The percentage of financing costs to net revenue stream increases significantly over the medium term. This is through a combination of increased capital investment – predominantly for commercial and regeneration purposes – and the expected reduction in funding primarily related to business rates and new homes bonus. Although this indicator identifies increased risk, the majority of increased financing costs are planned to be offset by income from commercial and regeneration investment. Through prudent investment, it is anticipated investment income will be less volatile and more predictable than other financing income such as business rates and government grants. This is reflected in the financial strategy and medium term financial plan. All capital investment must be sustainable in the long term through revenue support by the Council or its partners. All capital investment decisions consider the revenue implications both in terms of servicing the finance and running costs of the new assets. The impact of the revenue implications is a significant factor in determining approval of projects. The use of capital resources has been fully taken into account in the production of the Council's MTFP.

8 Knowledge and Skills

8.1 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Strategic Finance Advisor and s151 Officer is a qualified accountant with many years' relevant experience. There are several other professionally qualified Finance Specialists within the Council's finance function, and the Council pays towards staff to study towards relevant qualifications including AAT and CCAB/CIMA. All officers involved in the treasury and investment management function have access to relevant technical guidance and training to enable them to acquire and maintain the appropriate level of expertise, knowledge and skills to undertake the duties and responsibilities allocated to them.

8.2 The Council also employs qualified property specialists / surveyors to manage land and property assets, and contribute to key asset decisions.

8.3 Legal specialist advice is provided to the Council through the SHAPE legal partnership.

8.4 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 and various property consultants as required. This approach is considered to be cost effective and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

8.5 Those charged with governance (Members of the Audit Governance and Standards Committee and the Executive) recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively. The Section 151 Officer will ensure that elected members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and responsibilities.

Investment Strategy

1 Introduction

1.1 The Council invests funds that it holds for four broad purposes:

i) because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **treasury management investments**),

ii) to support local public services by lending to or buying shares in other organisations (**service investments**),

iii) to earn investment income (known as **commercial investments** where this is the main purpose) to meet the wider needs of the Council, and

iv) to realise key the Council's key objective to become a Garden Town, by stimulating change that would be unlikely if left solely to market activity (**regeneration investments**).

1.2 This investment strategy meets the spirit of the requirements of statutory guidance issued by the government in January 2018, and focuses on the second, third, and fourth of these categories.

2 Treasury Management Investments

2.1 The Council typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA). The balance of treasury management investments is expected to fluctuate between £34m and £97m during the 2021/22 financial year.

2.2 The contribution that these investments make to the objectives of the Council is to support effective treasury management activities.

2.3 Full details of the Council's policies and its plan for 2021/22 for treasury management investments are covered in the treasury management strategy later in this document.

3 Service Investments – Loans

3.1 The Council lends money to local businesses, local charities, other local authority partnerships, and local residents to support local public services and priorities, and stimulate local economic growth. Currently the Council has loans invested with:

- Somerset County Cricket Club – delivering the new Pavilion and bringing international cricket to Somerset.
- Great Western Hotel (YMCA) – regenerating a derelict building, and creating employment and training
- Hestercombe House and Gardens – enabling loan for development feasibility work
- Somerset Waste Partnership – for waste vehicles, with added benefit of keeping waste contract costs down
- Residents – housing related mortgages
- Centre for Outdoor Activity and Community Hub (COACH) – purpose built community centre including a café, conference suite, changing rooms, boat store and home to 5 community sports clubs

3.2 The Council also has agreements in place to provide loans if required to the Onion Collective CIC for the Watchet East Quay redevelopment scheme, and to Great Western Railway for improvements to Taunton Station. The Council has also included provision in its Capital Programme to provide further loan finance to the Somerset Waste Partnership for new vehicles, depot works and bins / boxes to deliver Recycle More under the new waste contract.

3.3 The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to minimise this risk and ensure that total exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding loans to each category of borrower have been set as follows:

TABLE 12	Loans for Service Purposes			
	Actual as at 31 March 2020			2021/22
	Balance Owing £'000	Loss Allowance £'000	Net figure in accounts £'000	Approved Limit £'000
Category of borrower:				
Businesses	6,423	(34)	6,389	7,000
Charity / Community	33	(1)	32	2,000
Local Authorities	0	0	0	6,800
Residents	185	0	185	1,200
Total	**6,641**	**-35**	**6,606**	**17,000**

3.4 Accounting standards require the Council to set aside a loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Councils statement of accounts will be shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

3.5 The Council assesses the risk of loss before entering into and whilst holding service loans by working up a robust business case and applying due diligence to all requests for service loans, and proportionate monitoring of credit risk of borrowers. For example, with loans to key businesses the Council's finance specialist team (qualified accountants) will review financial statements and service officers will maintain communication with the borrower in order that emerging risks are identified promptly. The Council will use credit rating information where available, and will use external specialist advisors if appropriate.

3.6 It is anticipated that the Council will complete its commercial investments programme during 2021/22. The focus will then shift to evolving the regeneration programme by establishing a subsidiary group structure to secure delivery, maximising funding opportunities and managing risk through a wider skill set by creating potential to involve all sectors – private, public and third.

4 Service Investments – Shares

4.1 The Council does not currently hold any direct investment in the shares of subsidiaries, its suppliers or local businesses. As part of the Council's commercialisation agenda, the Council may explore opportunities to establish wholly-owned or partly-owned trading companies. In any such case, appropriate business cases, due diligence, risk assessment and governance proposals will be developed for consideration of Full Council. In addition, relevant provisions would be added to the Investment Strategy including the expected contribution to the Council's strategies and priorities, and the security and liquidity of investments.

5 Commercial Investments – Property

5.1 The Council invests in a diverse investment property portfolio both locally and nationally with the intention of generating surplus income that will be spent on local public services delivered within the district. This is an essential response to significant reductions in government funding over recent years and further reductions expected in future, in order to meet service delivery objectives and the place making role of the Council, and avoid service cuts. The council plans to increase its investment by up to £100m by the end of 2021/22.

5.2 The Council holds a number of assets that were initially acquired for service purposes such as benefitting the local economy but have since been reclassified as investment properties. These are now established and the main purpose for holding the assets is for rental income. The following table summarises the investment properties held by the Council on 1 April 2020 and purchased since then.

TABLE 13	**Properties held for investment purposes £'000**
Properties in accounts as at 1 April 2020	
Land used for Scrap Yard, Priory Way, Taunton	546
The Arcade (Formerly The Carousel or K's)	314
Roughmoor Enterprise Centre (Employment Workspace)	1,405
Blackdown Business Park, Wellington (4 Units)	1,308
Mecca Bingo, Corporation Street, Taunton	1,614
All Others (values <£250k)	1,577
Subtotal	**6,764**

TABLE 13	Properties held for investment purposes £'000
Disposals During 2020/21	
Land used for Scrap Yard, Priory Way, Taunton	-546
Properties added during 2020/21	
Aztec West, Bristol	9,100
Wickes Extra, Birmingham	9,810
B&Q Ayr	6,600
The Range, Halifax	5,445
Total all properties	**37,173**

5.3 In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs. The Council also recognises that asset values may increase and decrease over time due to market volatility, and takes a long term perspective with the assumption that capital values are likely to hold or grow over the life of the asset.

5.4 Where value in accounts is at or above purchase cost:

5.5 A fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. Should the 2020/21 year end accounts preparation and audit process value these properties below their purchase cost, then an updated investment strategy will be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

5.6 The Council assesses the risk of loss before entering into and whilst holding property investments by undertaking appropriate due diligence including full valuation surveys and operating an asset management plan. The Council also considers strength of local market conditions to give confidence on future re-letting and also considers possible alternative uses if appropriate, and actively monitors the portfolio to ensure tenant obligations for maintaining assets are fulfilled.

5.7 Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Council actively manages cash flow through its treasury management arrangements and plans to under-borrow against its CFR so that it can temporarily borrow at short notice if required.

6 Regeneration Schemes

6.1 The Council has a vision for a Garden Town. The Garden Town is symbolic of Taunton's ambitions to flourish. As the county town for Somerset and an important centre of growth for the South West, we want to lead by reputation. We are developing our plans for the town, and involving our communities is at the heart of our approach. Our principles are clear and will help shape the approach to creating a healthy, vibrant and attractive place to live and work." This vision is currently being realised through the regeneration schemes outlined below.

6.2 There is a common risk for all regeneration activity relating to the actual and potential presence of phosphates in the Somerset Levels. The Environment Agency has identified that current amounts indicate contamination and there needs to be mitigation going forward. The nature of the problem and mitigation needed are likely to cause elapsed time beyond the originally anticipated timetables, plus added costs. It is too early to identify either time or cost impact at present.

Seaward Way, Minehead

6.3 The scheme was approved by WSC Full Council in November 2017 following a number of years exploring options for the site, including retail, commercial and residential. There are issues with flooding and drainage that make the scheme relatively expensive, particularly the common infrastructure necessary to mitigate these issues, and the engineering necessary in the ground to raise levels and provide retaining structures to the residential development where required. This resulted in a lengthy planning approval process, which was granted for both light industrial and residential elements of the project.

6.4 The light industrial portion consisting of 2 units were completed in December 2020/January 2021 and the tenants are in the process of taking occupation. The development of the residential portion is in the early stages of development.

Coal Orchard Re-Development (expected completion date June 2021)

6.5 The Coal Orchard is a mixed use commercial and residential scheme based on a brown field site with river frontage in the heart of Taunton town centre, immediately adjacent to the Brewhouse Theatre and former Coal Orchard car park.. All the land for this development is owned by the Council.

6.6 Somerset West and Taunton are bringing this project forward as a regeneration site, that if we didn't develop as a local authority would most likely not be developed commercially. This is in part due to the planning restrictions that limit density and height, but also the significant public realm contribution required to link up existing pedestrian and cycle ways, opening up the river frontage and create a new sense of place.

Firepool Re-Development

6.7 In March 2020 Council approved a £2.235m budget to develop the Firepool Masterplan. The Masterplan delivers the grand boulevard and other high quality public realm linking Train Station to the river and then on into the Town Centre. It also provides a highly sustainable solution that will be as close to zero carbon as practicable. The masterplan promotes the site for a leisure based destination scheme on the largest development Block, closest to the Town Centre, together with housing and a hotel.

6.8 The intention is that this supports the Town Centre by encouraging new and longer visits to the Town. It is a significant improvement in the retail and office led legacy Outline approval secured by the previous developer (St Modwen). This is a regeneration site that may also offer income earning opportunities.

Other regeneration sites

6.9 There are other sites the Council is considering and drafting proposals for.

7 Financial Guarantees

7.1 Although not strictly counted as investments, since no money has exchanged hands yet, financial guarantees carry similar risks to the Council and are included here for completeness.

7.2 The following guarantees were transferred to the Council from TDBC and WSC on 1 April 2019:

- South West Audit Partnership Limited Pension Liability £0.268m (as at 31 March 2019)
- Somerset Waste Partnership Pension Liability (minimal)

8 Proportionality

8.1 The Council currently has a low dependency on investment property income, but with increased investment the Council plans to become dependent on income generating investment activity to achieve a balanced revenue budget. Table 14 below shows the extent to which the expenditure planned to meet the service delivery objectives and place making role of the Council is dependent on achieving the expected net income from investments over the lifecycle of the Medium Term Financial Plan. Should it fail to achieve the expected net income, the Council’s contingency plans for continuing to provide these services including holding adequate funds in an earmarked Investment Risk Reserve as well as carrying adequate

General Reserves. Budget estimates are also set using prudent assumptions about net income from the portfolio including an allowance for voids / non-collection.

TABLE 14	Proportionality of Investments						
	2019/20 Actual £'000	2020/21 Revised £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
Gross Service expenditure	87,309	87,140	91,144	92,818	93,170	93,782	94,683
Investment income	(525)	(867)	(5,232)	(6,680)	(7,100)	(7,100)	(7,100)
Proportion	0.6%	1.0%	5.7%	7.2%	7.6%	7.6%	7.5%

8.2 Investment income shown in the above table is the gross income included in the budget estimates, disregarding asset management and capital financing costs. The rising proportion % shows an increased reliance on income from investment to fund services as other funding sources such as business rates and government grants diminish.

9 Borrowing In Advance of Need

9.1 Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The Council has chosen not to follow this guidance in the short term only in respect of the near term planned investment in property which is a fundamental plank of the financial strategy. Although disregarding the Government Guidance for a short period, the strategy is regarded as prudent because we have strong governance and due diligence in place to minimise risk and the investment is asset-backed. The overriding need for income to fund services is regarded as essential in order to meet ongoing needs of residents, given the large scale reductions, and increased uncertainty and volatility, in grant funding from Government and business rates. Increasing and diversifying income is also a key part of the Council's financial strategy in this context as we cannot rely on Government funding. It is intended that this previously identified and approved activity will be completed during 2021/22, balancing the risk and spread of the portfolio whilst maintaining a proportionate total level of investment. The financial strategy also plans to reduce debt related to the portfolio by an annual provision for debt repayment, potential use of revenue surpluses to finance investment, and in the long term through utilising capital growth in the Fund.

10 Capacity, Skills and Culture

10.1 Officers involved in the investment making decision process are governed by internal procedures and processes and external statutory guidance in the form of the CIPFA Treasury Management Code and MHCLG Investment guidance. Internally limits are set in the annual Treasury Management Strategy Statement and the overriding Treasury Management Practices. The Council team dealing with investment assessments and management are professionally qualified and experienced in their field of property, finance and legal, with access to training as required. Specialist advice will also be bought in for non-traditional property investments as required.

10.2 Members on the Investment Board are responsible for the commercial and finance portfolios, and will have access to relevant commercial property training for example as provided by the LGA or CIPFA as well as being advised by professional specialists.

10.3 The Commercial Investment function will lead on business case development and engagement with the market, including negotiations for acquisitions and disposals, operating within parameters set by Council within the approved commercial strategy. The team is guided by the Assistant Director - Finance (S151 Officer) and other finance specialists on the prudential framework and guidance within which the Council operates.

10.4 The Council recognises that the governance arrangements for building and managing a commercial investment property portfolio needs to be agile, and appropriately resourced to enable opportunities to be assessed and investment decisions to be made quickly. Appropriate time is also allowed before completion to enable full due diligence and legal agreements to be finalised. Full Council is responsible for agreeing the strategy and total fund value, with delegated authority given to the Investment Board to approve individual transactions within the portfolio. The Board consists of the Leader and two Portfolio Holders, the Chief Executive, and S151 Officer, and two Members from the non-ruling group may attend but without voting rights. The Board is advised by an Investment Panel that reviews projects and recommends for approval, with individual opportunities assessed by a Project Group consisting of key specialists.

11 Investment Indicators

11.1 The Council has set the following quantitative indicators to allow elected measures and the public to assess the Council’s total risk exposure as a result of its investment decisions.

Total investment exposure:

11.2 This indicator shows the Council's total exposure to potential investment losses. It includes amounts the Council is contractually committed to lend but have yet to draw down and guarantees the Council has issued.

TABLE 15	Total Investment Exposure						
All values at year end	2019/20 Actual £'000	2020/21 Revised £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
Treasury Management Investments:							
Strategic Funds	8,000	14,000	14,000	14,000	14,000	14,000	14,000
Other	5,026	5,000	3,000	3,000	5,000	5,000	5,000
Service investments - property	6,606	5,724	4,496	3,196	1,696	396	0
Commercial property investments	6,763	40,000	99,200	97,200	95,200	93,200	91,200
Total investments	**26,395**	**64,724**	**120,696**	**117,396**	**115,896**	**112,596**	**110,200**
Commitments to lend	7,500	7,875	3,200	1,200	1,200	1,200	1,200
Guarantees on pension liabilities	268	268	268	268	268	268	268
Total commitments and guarantees	**7,768**	**8,143**	**3,468**	**1,468**	**1,468**	**1,468**	**1,468**
Total Exposure	**34,163**	**72,867**	**124,164**	**118,864**	**117,364**	**114,064**	**111,668**

How investments are funded:

11.3 Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, it is difficult to comply with this guidance. However, the following investments could be described as being funded by borrowing. The remainder of the Council's investments are funded by usable reserves and income received just prior to need.

TABLE 16	Investments funded by borrowing						
	2019/20 Actual £'000	2020/21 Revised £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
Service investments - loans	6,606	5,724	4,496	3,196	1,696	396	0
Commercial investments - property	6,763	40,000	99,200	97,200	95,200	93,200	91,200
Commitments to lend	7,500	7,875	3,200	1,200	1,200	1,200	1,200
Total funded by borrowing	**20,869**	**53,599**	**106,896**	**101,596**	**98,096**	**94,796**	**92,400**

Rate of return received:

11.4 The Council seeks to achieve a commensurate rate of return in line with this investment objectives and risk appetite. For service loans, the rate of return will be set with the aim of covering financing costs (or opportunity costs) plus a premium for risk. Arrangement. The target return on investment properties is commercially sensitive and therefore not disclosed, however the Council expects to offset its acquisition, financing and management costs and provide a net income to fund local services.

Other investment indicators:

11.5 The Government’s investment guidance suggests authorities should consider a range of other quantitative indicators to show risks and opportunities in respect of investment and borrowing. The Council will therefore develop appropriate indicators and present these as part of the mid-year report.

Treasury Management Strategy

1 Introduction

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

1.2 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

1.3 Investments held for service purposes and for commercial income generation are considered in the Investment Strategy above.

2 External Context

2.1 The treasury strategy appropriately considers the wider economic picture. The Council's treasury advisor, Arlingclose, has provided a summary commentary on this wider context and their own interest rate forecasts, and is provided in Appendix A.

3 Local Context

3.1 On 31 December 2020, the Council held £112.5m of borrowing, (£85.5m long term and £27.0m short term) and £32.5m of treasury investments. These balances are summarised in Table 17 below.

TABLE 17	Existing investment and debt portfolio position		
	2020/21 31-Dec-20 £'000	**Average Rate %**	**2019/20 31-Mar-20 £'000**
External borrowing			
PWLB	(82,500)	2.79	(76,000)
Barclays	(3,000)	4.25	(3,000)
Other local authorities / UK public bodies	(27,000)	0.60	(22,000)
Total External borrowing	**(112,500)**	2.32	**(101,000)**
Treasury investments:			
Banks and building societies (unsecured)	822	0.00	2,384
Covered bonds (secured)	-		2,092
Government incl local authorities	7,085	0.00	4,840
Fixed Term deposits	-		0
Money Market Funds	9,050	0.01	7,768
Corporate Funds & multi asset investments	15,512	3.54	16,632
Certificates of deposit	-		0
Total Treasury Investments	**32,469**	**1.77**	**33,717**
Net Debt	**(80,031)**		**(67,283)**

3.2 Forecast changes in these sums are shown in the balance sheet analysis in Table 18 below.

TABLE 18	Balance Sheet Summary and Forecast						
	2019/20 Actual £'000	2020/21 Revised £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000	2024/25 Estimate £'000	2025/26 Estimate £'000
Capital Financing Requirement (CFR)							
General Fund	33,944	55,422	77,948	99,671	123,577	119,967	115,431
HRA	107,982	106,225	122,507	142,510	150,850	156,327	163,053
Investments	0	40,000	100,000	100,000	100,000	100,000	100,000
Total CFR	**141,926**	**201,648**	**300,455**	**342,182**	**374,426**	**376,294**	**378,485**
Less: External Borrowing	(101,000)	(164,011)	(260,926)	(305,268)	(340,908)	(349,303)	(359,039)
Less: Other debt liabilities (leases)	0	0	0	0	0	0	0
Internal Borrowing	40,926	37,637	39,529	36,914	33,518	26,990	19,446
Less: Usable reseves	(60,530)	(44,570)	(32,889)	(31,639)	(31,639)	(31,639)	(31,639)
Working capital (surplus) / deficit	(19,531)	(24,300)	(24,300)	(24,300)	(24,300)	(24,300)	(24,300)
Total Treasury (Investments)/new borrowing	**(39,135)**	**(31,233)**	**(17,660)**	**(19,025)**	**(22,421)**	**(28,949)**	**(36,493)**

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

3.4 The Council has an increasing CFR due to the capital programme including anticipated investment property acquisition. The trend of increased expenditure and forecast borrowing indicates it could have scope to invest up to £36.5m over the forecast period.

3.5 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 18 shows that the Council expects to comply with this recommendation over the medium term.

Liability benchmark:

3.6 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 19 above, but that cash and investment balances are kept to a minimum level of £17m to £19m at each year-end to maintain sufficient liquidity but minimise credit risk.

TABLE 19	**Liability Benchmark**						
	2019/20 Actual £'000	**2020/21 Revised £'000**	**2021/22 Estimate £'000**	**2022/23 Estimate £'000**	**2023/24 Estimate £'000**	**2024/25 Estimate £'000**	**2025/26 Estimate £'000**
Total CFR	141,926	201,648	300,455	342,182	374,426	376,294	378,485
Less External borrowing	(101,000)	(164,011)	(260,926)	(305,268)	(340,908)	(349,303)	(359,039)
Less: Usable reseves	(60,530)	(44,570)	(32,889)	(31,639)	(31,639)	(31,639)	(31,639)
Working capital (surplus) / deficit	(19,531)	(24,300)	(24,300)	(24,300)	(24,300)	(24,300)	(24,300)
Plus: Minimum investments	13,026	19,000	17,000	17,000	19,000	19,000	19,000
Liability Benchmark	**(26,109)**	**(12,233)**	**(660)**	**(2,025)**	**(3,421)**	**(9,949)**	**(17,493)**

4 Borrowing Strategy

4.1 The Council currently holds £112.5m of loans (including short term) as at 31 December 2020, compared to £101.0m on 1 April 2020, as part of its strategy for funding previous years' capital programmes (Table 17). The balance sheet forecast in Table 18 shows that the Council expects to borrow up to £97.0m in 2021/22. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £340.0m in 2022/23.

4.2 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.

4.3 Given the significant cuts to public expenditure and in particular 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. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short term to either use internal resources, or to borrow short term loans instead.

4.4 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2021/22 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

4.5 The Council (and its predecessors) has previously raised the majority of its long-term borrowing from the PWLB but the government increased PWLB rates by 1% in October 2019 making it a relatively expensive option. It subsequently did an about turn in November/December 2020, reducing PWLB rates but also introducing new parameters around use of these funds. The Council consequently began and continued exploration in 2020 of alternative options to borrow any long-term loans from other sources including banks, pensions and local authorities, and will 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 Code. It is likely the Council will seek to refinance existing loans needed for treasury purposes from the PWLB (such as HRA PWLB loans) as these mature over the medium term, however additional long-term borrowing will be sought from other sources whilst the PWLB restrictions remain in place. Short term borrowing from other local authorities will be prioritised whilst interest rate forecasts remain low, which is expected to be the case over the medium term.

4.6 Alternatively, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period (although forward loan interest rates will usually factor in an allowance for interest rate risk during the intervening period).

4.7 Additionally, the Council may borrow further short term loans to cover unplanned cash flow shortages.

4.8 The borrowing strategy seeks to manage the overall borrowing cash requirements for the Council and does not look to assign individual debt facilities to individual capital items. The approach and duration of debt will however is planned to follow the needs based on capital investment requirements. For example:

- Investment Properties: In order to maintain flexibility to reduce debt in relation to investment properties, the approach will look to utilise a blend of cash (internal borrowing) and short term debt whilst rates remain low, together with potential longer term facilities over 5-15 years. This will seek to avoid carrying debt unnecessarily and reduce investment related borrowing through MRP and capital growth.

- Regeneration: A range of financing options will support planned investment in regeneration. This may for example be through a combination of shorter term and longer term investment directly or through a Council-owned company structure, and borrowing will be planned based on the nature of financial investment undertaken by the Council

- Housing: Loans for the HRA are accounted for in a separate 'pool' to general fund loans. The planned approach is to refinance existing PLWB loans in line with the HRA business plan requirements. Additional borrowing may need to be sought from other sources, which will be planned to meet the expected debt requirements within the Business Plan.

4.9 The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- Any institution approved for investments (see below)
- Any other bank or building society authorised to operate in the UK
- Any other UK public sector body
- UK public and private pension funds (except Somerset County Pension Fund)
- Capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

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

- Leasing
- Hire purchase
- Sale and leaseback

4.11 Municipal Bonds Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason;

and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

4.12 Short-term and variable rate loans: These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

4.13 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. 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.

5 Treasury Investment Strategy

5.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the first six months of 2020/21 to 30th September 2020, the Council's investment balance ranged between £34.0m and £97.3m, and similar levels are expected to be maintained in the forthcoming year.

5.2 The CIPFA 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.

5.3 As the UK enters into another very uncertain year in 2021/22, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

5.4 Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to further diversify into more secure and/or higher yielding asset classes during 2020/21. This is especially the case for the estimated £20.0m that is available for longer-term investment. A proportion of the Council's surplus cash is currently invested in short-term unsecured bank deposits, money market funds and other local authorities. This diversification will represent a continuation of the new strategy adopted in earlier years, with an enhanced opportunity to utilise strategic investment pooled funds as the resources of the two predecessor Councils are combined.

5.5 Under the IFRS 9 standard, the accounting for certain investments depends on the Council's 'business model' for managing them. The Council aims to achieve value for money 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.

Approved Counterparties

5.6 The Council may invest its surplus funds with any of the counterparty types in table 20 below, subject to the cash limits (per counterparty) and the time limits shown.

TABLE 20	**Counterparty Limit**	
Sector	**Time limit**	**Amount**
The UK Government	50 years	Unlimited
Local Authorities & other gov't entities	5 years	£7million
Secured investments *	5 years	£7million
Banks (unsecured) *	13 months	£7million
Building Societies (unsecured) *	13 months	£7million
Registered Providers (unsecured) *	5 years	£7million
Money Market funds *	n/a	£7million
Strategic Pooled funds	n/a	£7million
Real estate investment trusts	n/a	£7million
Other investments *	5 Years	£5million

5.7 **Credit rating:** (*) Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

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

5.9 **Secured investments:** Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

5.10 **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. See below for arrangements relating to operational bank accounts.

5.11 **Registered providers (unsecured):** 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.

5.12 **Money market funds:** Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

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

5.14 **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.

5.15 **Other investments:** This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.

5.16 **Operational bank accounts:** The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £500,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

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

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

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

5.19 **Other information on the security of investments**: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

5.20 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills 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

5.21 The Council's revenue reserves available to cover investment losses are forecast to be £28m on 31 March 2021. In order that no more than 25% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £7m. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

TABLE 21	Invesment Limits
	Cash limit
UK Central government	unlimited
Any other single organisation	£7m each
Any group of organisations under the same ownership	£7m per group
Any group of pooled funds under the same management	£21m per manager
Negotiable instruments held in a broker's nominee account	£21m per broker
Foreign countries	£7m per country
Registered providers and registered social landlords	£21 in total
Unsecured investments with building societies	£7m in total
Loans to unrated corporates	£7m in total
Money market funds	£42m in total
Real estate investment trusts	£21m in total

5.22 **Liquidity management**: The Council uses an in-house spreadsheet based cash flow forecasting model 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.

6 Treasury Management Indicators

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

Security

6.2 The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its 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.

Credit risk indicator	Target
Portfolio average credit rating	A-

Liquidity

6.3 The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

Liquidity risk indicator	**Target**
Total cash available within 3 months	£20m

Interest Rate Exposures

6.4 This indicator is set to control the Council's exposure to interest rate risk. The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	**Limit**
Upper limit on one-year revenue impact of a 1% *rise* in interest rates	£50,000
Upper limit on one-year revenue impact of a 1% *fall* in interest rates	£50,000

Maturity Structure of Borrowing

6.5 This indicator is set to control the Council's exposure to refinancing risk. The limits set for each category within this indicator is wide since the indicator is only to cover the risk of replacement loans being unavailable, not interest rate risk. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	**Upper limit**	**Lower limit**
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Principal Sums Invested For Periods Longer Than a Year

6.6 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 limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	**2021/22**	**2022/23**	**2023/24**
Limit on principal invested beyond year end	£30m	£25m	£25m

7 Related Matters

7.1 **Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). 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).

7.2 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

7.3 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

7.4 In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

7.5 Housing Revenue Account: On 1 April 2012, the Council’s predecessor (TDBC) notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA’s underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund and HRA at the Council's average interest rate on investments, adjusted for credit risk.

7.6 Markets in Financial Instruments Directive: The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the S151 Officer believes this to be the most appropriate status.

8 Financial Implications

8.1 The budget for treasury investment income and debt interest in 2021/22 is summarised as follows:

TABLE 22	**Interest income and costs - Budget estimates**		
	2021/22 Investment Income £'000	**2021/22 Interest cost £'000**	**2021/22 Net (income) or cost £'000**
General Fund	(515)	313	(202)
HRA	0	2,669	2,669
Total	**(515)**	**2,982**	**2,467**

8.2 If actual levels of investments and borrowing, or actual interest rates differ from those forecast, performance against budget will be correspondingly different. Significant variances will be identified in budget monitoring reports to the Senior Management Team and the Executive.

9 Other Options Considered

9.1 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The S151 Officer, having consulted the Portfolio Holder for Corporate Resources, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Appendix A

External Context
Economic background:

The impact on the UK from coronavirus, lockdown measures, the rollout of vaccines, as well as the new trading arrangements with the European Union (EU), will remain major influences on the Authority's treasury management strategy for 2021/22.

The Bank of England (BoE) maintained Bank Rate at 0.10% in December 2020 and Quantitative Easing programme at £895 billion having extended it by £150 billion in the previous month. The Monetary Policy Committee (MPC) voted unanimously for both, but no mention was made of the potential future use of negative interest rates. In the November Monetary Policy Report (MPR) forecasts, the Bank expects the UK economy to shrink -2% in Q4 2020 before growing by 7.25% in 2021, lower than the previous forecast of 9%. The BoE also forecasts the economy will now take until Q1 2022 to reach its pre-pandemic level rather than the end of 2021 as previously forecast. By the time of the December MPC announcement, a COVID-19 vaccine was approved for use, which the Bank noted would reduce some of the downside risks to the economic outlook outlined in the November MPR.

UK Consumer Price Inflation (CPI) for November 2020 registered 0.3% year on year, down from 0.7% in the previous month. Core inflation, which excludes the more volatile components, fell to 1.1% from 1.5%. The most recent labour market data for the three months to October 2020 showed the unemployment rate rose to 4.9% while the employment rate fell to 75.2%. Both measures are expected to deteriorate further due to the ongoing impact of coronavirus on the jobs market, particularly when the various government job retention schemes start to be unwound in 2021, with the BoE forecasting unemployment will peak at 7.75% in Q2 2021. In October, the headline 3-month average annual growth rate for wages were 2.7% for total pay and 2.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up by 1.9% while regular pay was up 2.1%.

GDP growth rebounded by 16.0% in Q3 2020 having fallen by -18.8% in the second quarter, with the annual rate rising to -8.6% from -20.8%. All sectors rose quarter-on-quarter, with dramatic gains in construction (41.2%), followed by services and production (both 14.7%). Monthly GDP estimates have shown the economic recovery slowing and remains well below its pre-pandemic peak. Looking ahead, the BoE's November MPR forecasts economic growth will rise in 2021 with GDP reaching 11% in Q4 2021, 3.1% in Q4 2022 and 1.6% in Q4 2023.

GDP growth in the euro zone rebounded by 12.7% in Q3 2020 after contracting by -3.7% and -11.8% in the first and second quarters, respectively. Headline inflation, however, remains extremely weak, registering -0.3% year-on-year in November, the fourth successive month of deflation. Core inflation registered 0.2% y/y, well below the European Central Bank's (ECB) target of 'below, but close to 2%'. The ECB is expected to continue holding its main interest rate of 0% and deposit facility rate of -0.5% for some time but expanded its monetary stimulus in December 2020, increasing the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

The US economy contracted at an annualised rate of 31.4% in Q2 2020 and then rebounded by 33.4% in Q3. The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% and announced a change to its inflation targeting regime to a more flexible form of average targeting. The Fed also provided strong indications that interest rates are unlikely to change from current levels over the next three years.

Former vice-president Joe Biden won the 2020 US presidential election. Mr Biden is making tackling coronavirus his immediate priority and will also be reversing several executive orders signed by his predecessor and take the US back into the Paris climate accord and the World Health Organization.

Credit outlook: After spiking in late March as coronavirus became a global pandemic and then rising again in October/November, credit default swap (CDS) prices for the larger UK banks have steadily fallen back to almost pre-pandemic levels. Although uncertainly around COVID-19 related loan defaults lead to banks provisioning billions for potential losses in the first half of 2020, drastically reducing profits, reported impairments for Q3 were much reduced in some institutions. However, general bank profitability in 2020 and 2021 may be significantly lower than in previous years.

The credit ratings for many UK institutions were downgraded on the back of downgrades to the sovereign rating. Credit conditions more generally though in banks and building societies have tended to be relatively benign, despite the impact of the pandemic.
Looking forward, the potential for bank losses to be greater than expected when government and central bank support starts to be removed remains a risk, suggesting a cautious approach to bank deposits in 2021/22 remains advisable.

Interest rate forecast:
The Authority's treasury management adviser Arlingclose is forecasting that BoE Bank Rate will remain at 0.1% until at least the first quarter of 2024. The risks to this forecast are judged to be to the downside as the BoE and UK government continue to react to the coronavirus pandemic and the new EU trading arrangements. The BoE extended its asset purchase programme to £895 billion in November while keeping Bank Rate on hold and maintained this position in December. However, further interest rate cuts to zero, or possibly negative, cannot yet be ruled out but this is not part of the Arlingclose central forecast.

Gilt yields are expected to remain very low in the medium-term while short-term yields are likely remain below or at zero until such time as the BoE expressly rules out the chance of negative interest rates or growth/inflation prospects improve. The central case is for 10-year and 20-year to rise to around 0.60% and 0.90% respectively over the time horizon. The risks around the gilt yield forecasts are judged to be broadly balanced between upside and downside risks, but there will almost certainly be short-term volatility due to economic and political uncertainty and events.

A more detailed economic and interest rate forecast provided by Arlingclose is attached below.

Arlingclose Economic & Interest Rate Forecast – December 2020

Underlying assumptions:

- The medium-term global economic outlook has improved with the distribution of vaccines, but the recent upsurge in coronavirus cases has worsened economic prospects over the short term.
- Restrictive measures and further lockdowns are likely to continue in the UK and Europe until the majority of the population is vaccinated by the second half of 2021. The recovery period will be strong thereafter, but potentially longer than previously envisaged.
- Signs of a slowing UK economic recovery were already evident in UK monthly GDP and PMI data, even before the second lockdown and Tier 4 restrictions. Employment is falling despite an extension to support packages.
- The need to support economic recoveries and use up spare capacity will result in central banks maintaining low interest rates for the medium term.
- Brexit will weigh on UK activity. The combined effect of Brexit and the after-effects of the pandemic will dampen growth relative to peers, maintain spare capacity and limit domestically generated inflation. The Bank of England will therefore maintain loose monetary conditions for the foreseeable future.
- Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid longer-term inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or the deployment of vaccines.

Forecast:

- Arlingclose expects Bank Rate to remain at the current 0.10% level.
- Our central case for Bank Rate is no change, but further cuts to zero, or perhaps even into negative territory, cannot be completely ruled out.
- Gilt yields will remain low in the medium term. Shorter term gilt yields are currently negative and will remain around zero or below until either the Bank expressly rules out negative Bank Rate or growth/inflation prospects improve.

- Downside risks remain, and indeed appear heightened, in the near term, as the government reacts to the escalation in infection rates and the Brexit transition period ends.

	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Official Bank Rate													
Upside risk	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-month money market r													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.15	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
1yr money market rate													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.15	0.15	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Downside risk	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
5yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.00	0.00	0.05	0.10	0.15	0.20	0.20	0.20	0.25	0.25	0.25	0.25	0.25
Downside risk	0.40	0.45	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60
10yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.25	0.30	0.35	0.35	0.40	0.40	0.45	0.45	0.50	0.55	0.55	0.55	0.60
Downside risk	0.50	0.50	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55
20yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.70	0.70	0.75	0.75	0.75	0.80	0.80	0.85	0.85	0.85	0.85	0.90	0.90
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
50yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.60	0.60	0.65	0.65	0.65	0.70	0.70	0.75	0.75	0.75	0.75	0.80	0.80
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

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

PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Minimum Revenue Provision (MRP) Statement

1 Policy Statement

1.1 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 Ministry of Housing, Communities and Local Government’s Guidance on Minimum Revenue Provision (the MHCLG Guidance) most recently issued in 2018.

1.2 The broad aim of the MHCLG Guidance is to ensure that capital expenditure is financed over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

1.3 The MHCLG 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.

1.4 The predecessor Councils (TDBC and WSC) both adopted an MRP calculation method which spread the total Capital Financing Requirement over the weighted average useful life of each Council’s asset base on a straight line basis. The calculation took into consideration the materiality of each asset and its recorded remaining useful life. The weighted average was then applied to the class of asset then applied across the whole fixed asset base. That gave a robust basis to support the asset life applied to MRP calculations and be appropriate for audit scrutiny.

1.5 Following the creation of the Somerset West and Taunton Council on 1 April 2019, it is proposed to apply the same methodology for the opening balance General Fund CFR using the combined weighted average useful life of the consolidated asset base transferred to SWTC on 1 April. This is considered a prudent approach to charging for the legacy CFR transferred to SWTC from its predecessor Councils.

1.6 For capital expenditure incurred since 1 April 2021, the proposed methods for calculating MRP are as follows:

- For Property Plant and Equipment (PPE) assets, MRP will be calculated over the weighted average useful life of each Council's asset base at the start of each financial year on a straight line basis.

- For assets acquired by leases or the Private Finance, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

- For capital grants and contributions to third parties MRP will be calculated on a straight-line basis over 25 years from the 1 April following the year in which the grants or contributions are incurred.

- For capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from the principal repayments to reduce the capital financing requirement in respect of those loans. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational. While this is not one of the options in the MHCLG Guidance, it is thought to be a prudent approach since it ensures that the capital expenditure incurred in the loan is fully funded over the life of the assets.

- For Investment Properties, MRP will be calculated over 50 years, or over the professionally assessed useful life of the asset if lower than 50 years. MRP may be calculated using either annuity or straight-line basis as determined by the s151 Officer.

- For Housing Revenue Account capital expenditure, MRP will be charged on a straight-line over 60 years.

1.7 For capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan

1.8 MRP is charged based on the opening balance CFR carried forward from the previous year. Therefore Capital expenditure incurred during 2021/22 will not be subject to a MRP charge until 2022/23.

2 Capital Financing Requirement and MRP Estimates

2.1 Based on the Council's latest estimate of its capital financing requirement (CFR) on 31 March 2021, the budget estimate for MRP has been set as follows:

Capital Financing Requirement (CFR) and Minimum Revenue Provision (MRP)	31-Mar-21 CFR Revised £'000	2021/22 MRP Estimate £'000
General Fund	95,422	(1,967)
HRA	106,225	(1,874)
Total	**201,648**	**(3,842)**

3 MRP Overpayments

3.1 Overpayments: In earlier years, the Council has made no voluntary overpayments of MRP that are available to reduce the revenue charges in later years. It is not planned to make an overpayment in 2020/21 or 2021/22, however the s151 Officer may determine such an overpayment during the year and report this through the Outturn Report. end