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People Scrutiny Committee

Date: Monday, 13 January 2020

Time: 2.00 pm

Venue: Committee Room A/B, South Walks House, South Walks Road, Dorchester, DT1 1EE

Membership: (Quorum 3)
Jane Somper (Chairman), Mary Penfold (Vice-Chairman), Toni Coombs, Stella Jones, Emma Parker, Molly Rennie, Mark Roberts, Maria Roe, Clare Sutton and Gill Taylor

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Chief Executive: Matt Prosser, South Walks House, South Walks Road, Dorchester, Dorset DT1 1UZ (Sat Nav DT1 1EE)

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A G E N D A

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1 APOLOGIES

To receive any apologies for absence.

2 DECLARATIONS OF INTEREST

To receive any declarations of interest.

3 PUBLIC PARTICIPATION

To receive questions or statements on the business of the committee from town and parish councils and members of the public.

4 URGENT ITEMS

To consider any items of business which the Chairman has had prior notification and considers to be urgent pursuant to section 100B (4) b) of the Local Government Act 1972. The reason for the urgency shall be recorded in the minutes.

5 PRE-DECISION SCRUTINY OF THE 2020/2021 BUDGET 3 - 58

The Scrutiny committees are asked to consider the budget proposals on behalf of the residents of Dorset, and to provide constructive challenge to decision-makers before a final decision is made.

6 EXEMPT BUSINESS

To move the exclusion of the press and the public for the following item in view of the likely disclosure of exempt information within the meaning of paragraph x of schedule 12 A to the Local Government Act 1972 (as amended).

The public and the press will be asked to leave the meeting whilst the item of business is considered.

There is no exempt business.

People Scrutiny Committee
13 January 2020
Pre-decision Scrutiny of the 2020/2021 Budget

For Recommendation to Cabinet

Portfolio Holder: Cllr T Ferrari, Finance, Commerical and Assets

Local Councillor(s): All

Executive Director: Aidan Dunn, Executive Director, Corporate Development

Report Author: Jim McManus
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Report Status: Public

Recommendation:
The Scrutiny committees are asked to consider the budget proposals on behalf of the residents of Dorset, and to provide constructive challenge to decision-makers before a final decision is made.

Reason for Recommendation:
The Council is required to set a balanced revenue budget, and to approve a level of council tax as an integral part of this. The Council is also required to approve a capital strategy, a capital programme and budget, and a treasury management strategy.

1. Executive Summary
Dorset Council has a statutory obligation to set a balanced budget. The three Scrutiny Committees (People, Place and Resources) are invited to consider budget proposals before they are presented to Cabinet on 28th January, prior to approval by Council on 18th February 2020 and implementation on 1st April. Progress against the budget is then reported to Cabinet and the Scrutiny Committee on a quarterly basis throughout the year.

These scrutiny meetings will provide members with the opportunity to consider the implications of these proposals on behalf of the residents of Dorset, and to provide constructive challenge to decision-makers before a final decision is made.

The recommendations made by the Committees at these meetings will be reported to Cabinet on 28 January 2020 and taken into consideration as part of the budget setting process.

This report sets out proposals for Dorset Council's 2020/21 revenue and capital budgets and summarises the medium-term financial plan (MTFP) which covers the following four years to 2024/25.

The report also includes the capital strategy and treasury management strategy.

2. Financial Implications

Financial information is set out in this report and Appendices.

3. Climate implications

Dorset Council declared a climate emergency at its first meeting on 16 May 2019.

The Council is mindful of the environmental impact of its work, and in making decisions it is required to consider the impact on the climate.

However, this report is concerned with financial strategy that enables other strategy and policy debate to take place within a balanced budget framework rather than driving or delivering climate policy itself.

4. Other Implications

None identified

5. Risk Assessment

Having considered the risks associated with this decision, the level of risk has been identified as:

Current Risk: HIGH

Residual Risk: HIGH

Significant additional resources have been incorporated into the budgets for services being delivered to Dorset Council's residents. However, the unpredictability and volatility of demand and the price sensitivity of some the complex services provided means that the budget can be significantly impacted by small changes to (for example) the numbers of looked-after-children or the numbers of adults needing support to live well at home.

The short-term nature of the Government's Spending Review, the local government finance settlement and continuing uncertainty around the impact of the UK's exit from the European Union mean there is significant risk to the Council's budget.

There is a well-developed risk-management process which will continue to frame our financial monitoring and reporting during the year.

6. Equalities Impact Assessment

This report does not deal with any new strategy or policy issues that would trigger the need for an impact assessment.

7. Evidence Sets

Evidence Set 1 Summary Report

Appendix 1 Sources of Funding

Appendix 2 High-level revenue budget summary

Appendix 3 MTFP assumptions 2020 - 2024

Appendix 4 Capital programme 2020-2024

Appendix 5 Capital strategy 2020-25

Appendix 6 Treasury management strategy 2020/21

8. Background Papers

Shadow Council 2019/20 Budget Paper	11th February 2019
Q1 Budget Report to Cabinet	30th July 2019
Q2 Budget Report to Cabinet	5th November

Footnote:

Issues relating to financial, legal, environmental, economic and equalities implications have been considered and any information relevant to the decision is included within the report.

Scrutiny Covering Report

1. Objectives of Pre- Budget Scrutiny

1.1 The objectives of these scrutiny meetings are to provide the Committees with an opportunity to consider:

a) the financial position of Dorset Council in the context of the current national political and economic landscape;

b) the Council's financial strategy and the options available to ensure services remain sustainable in 2020/21 and beyond;

c) the proposed budget for each directorate and comparisons with the previous year;

d) the current proposals for the Council's reserves policy and capital budget.

1.2 The papers have been prepared to provide the Committees with information to come to a view on the following key questions:

a) What is the impact of the national economic situation upon the Council's budget?

b) What is the Budget Strategy for 2020-24?

c) What are the Council tax assumptions for 2020/21?

d) What are the assumptions about levels of funding and financial pressures?

e) What is the proposed budget for 2020/21 for each directorate and how does it compare to 2019/20?

f) What is the capital programme for 2020-24, how has this been developed and what impact does it have on the revenue budget of the council?

g) What is the basis of the cost pressure figures?

h) What level of confidence is there with these figures?

i) What is the potential for the cost pressures to be understated and, if so, by how much?

j) What is being done, and is being planned to be done, to mitigate these cost pressures?

2. Background

2.1 In February 2019, the Council set a net expenditure budget of £295m for the year 2019/20. This is the budget after fees, charges, contributions and some specific grants have been deducted.

2.2 In September 2019, Cabinet received the first forecast for the 2019/20 revenue budgets, which predicted that the Base Budget would be overspent by £7.1m, the Dedicated Schools Grant Budget would be overspent by £5.5m.

2.3 The situation had deteriorated at Quarter 2, and Cabinet heard on 5 November 2019 that that the Base Budget was predicted to be overspent by £8.2m, the

Dedicated Schools Grant Budget by £6.5m. Cabinet will receive the Quarter 3 report for 2019/20 on 3rd March 2020.

2.4 The budget for 2020/21 will be presented to Cabinet for debate and approval on 28 January 2020, prior to consideration by the Full Council on 18 February 2020.

2.5 The scrutiny meeting will provide members with the opportunity to consider the implications of the proposals for the 2020/21 budget on behalf of the residents of Dorset, and to provide constructive challenge to decision-makers before a final decision is made. The recommendations made by the Committee will be taken into consideration as part of the budget setting process.

2.6 All councillors and statutory co-opted scrutiny members are invited to attend the meetings and, subject to the discretion of the Chairman, to raise questions on the day.

Evidence Set 1 – Main report

1. Introduction; the Council's priorities and budget strategy

1.1 The Council's budget provides a financial framework for the Council to achieve its priorities. These priorities are described in the draft Dorset Council Plan which was published in October 2019 and is due to be finalised at the January 2020 Cabinet meeting. The draft priorities are:

- Staying safe and well
- Economic Growth
- Unique Environment
- Suitable Housing
- Strong Healthy Communities

1.2 The Council's budget strategy is based on a commitment to deliver these priorities within the resources it has available. Following Local Government Reorganisation, the Council is becoming a leaner and more focused organisation, and costs continue to be reduced as the systems of the six predecessor councils converge into one. Further efficiencies and service improvements will be achieved through a portfolio of service transformation programmes that are fundamentally reviewing how services are operated and how the organisation is run.

1.3 However, in other areas costs are predicted to increase through inflation and growth in demand for services. These predicted changes in cost, income and funding are combined in Dorset Council's new, medium-term financial plan (MTFP). The MTFP is the financial model used by the Council to estimate its future resource requirements and the availability of funding. It is a cornerstone of the recommendations being made to Cabinet and Council in approving the 2020/21 revenue budget, capital budget, capital strategy and treasury management strategy.

2. Local, national and international contexts

2.1 This budget has been prepared against a backdrop of unprecedented levels of uncertainty and risk. There are hugely influential matters in progress which will impact not just on Dorset but on the country as a whole as they play out at a global level.

2.2 The challenges facing councils nationally continue and are well rehearsed. Although the Government's 2019 spending review was more positive than preceding rounds, it was still for one year only. There is considerable risk around future funding assumptions through streams such as social care grant and improved better care fund which are not formally part of base funding but which are essential for councils to continue to deliver services.

2.3 Although the settlement, announced by Government on 20 December 2019, indicates that this funding will continue for the remainder of the current parliament, the detail is yet to emerge, so we remain watchful over the relative

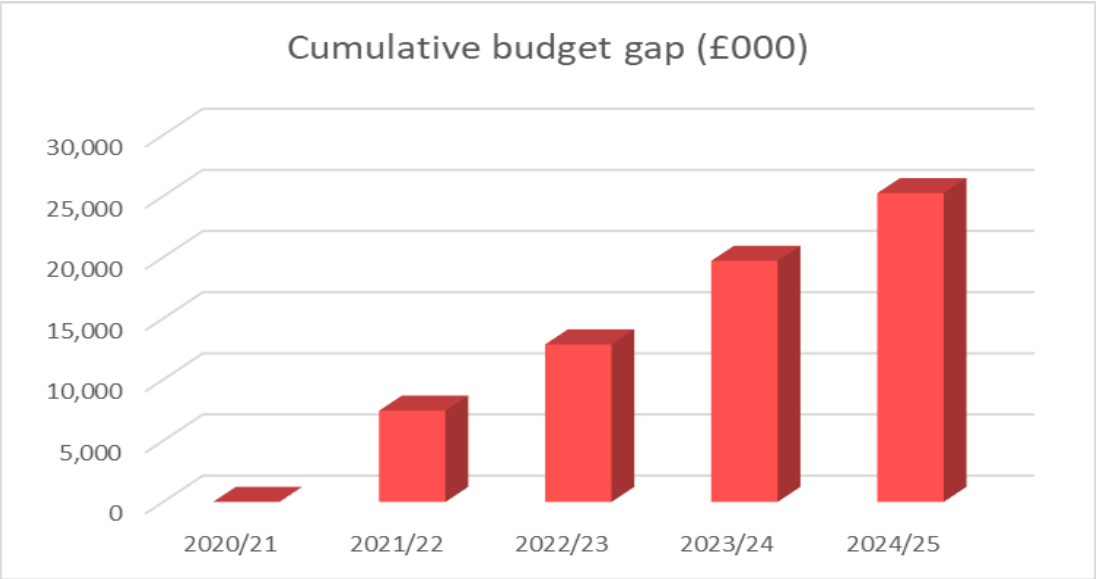
distribution of the funding between councils and other details that have yet to be confirmed.

2.4 The settlement confirmed that there were no changes to the methodology and allocations proposed in the technical consultation; the document on which the MTFP has been based. There were therefore no surprises for the Council. There are also indications of a return to multi-year settlements following the 2020 spending review which, if delivered, are to be welcomed.

3. MTFP, budget and financial strategy development

3.1 Appendix 3 sets out the key assumptions that have been incorporated into the budget strategy for 2020/21 and into the longer, MTFP period.

3.2 The council is required to set a balanced budget each year but not to balance its overall MTFP. The chart below shows how the assumptions included in the MTFP model flow-through to create budget gaps in the next four years. The council continues to work to close this gap through transformation, improved efficiency and tactical savings.



3.3 Dorset Council has a financial model which spans a ten-year planning period. The first five of these are the MTFP and the first year is the budget. The reliability of the model diminishes as it stretches further into the future – especially as there is considerable planning uncertainty beyond the current, one-year spending review. However, the model is an essential tool to inform the organisation of its likely financial risks and opportunities and helps inform organisation strategy.

3.4 In developing the budget for 2020/21 the first step was to build a new MTFP model. Each predecessor council had its own planning tool but none were suitable for the new unitary council. Development of the model involved active input from elected members at a corporate planning event in September as well as healthy engagement from Cabinet members and the Portfolio Holder for

Finance. As the model itself developed, Directorates were asked for fresh input of model parameters and data, including advice on cost and volume pressures, savings opportunities and assessments of market conditions, demand and commissioning intentions.

3.5 The purpose of this exercise was - and is - to ensure that there is a one-council approach to understanding the financial position, performance and potential of the organisation. Officers and elected members need to understand the budget and its contexts so they can explain clearly to residents how we align resources with priorities and articulate the pressures that we face in delivering more and better within our budgets.

3.6 Disappointingly, it has not been possible to estimate the impact of the implementation of further business rates retention or the fair funding review. Both pieces of work have been delayed nationally and will not be implemented before 2021/22. There is still very little detail to use to build future funding changes into the Council's financial model, so no attempt has been made to do this.

4. 2019/20 experience and context

4.1 The budget itself builds upon the experience of 2019/20, so it is essential to understand this before moving forward. There are several different strands of financial performance to address when considering the current year.

4.2 The budget report for 2019/20 set out a number of savings targets which would be possible for the converging councils. It is pleasing to be able to report that all of the cost reductions from reorganisation that were built into the budget are being achieved. These include (amongst other things) reduced internal and external audit costs, reductions on councillors' expenses and most significantly, staff costs savings from the convergence of support services.

4.3 As well as savings, the Council took the opportunity to harmonise its treasury strategy and operations, delivering a budget improvement of £2m for 2019/20. Actual performance will be better than this and a further improvement has therefore been incorporated into the 2020/21 budget.

4.4 The budget for 2020/21 builds on these cost reductions and seeks further consolidation of structures, systems, processes and assets. Not all of these workstreams are complete but savings set out as part of Appendix 1 are included. Further savings or cost reductions will also flow from the transformation programme which is currently in progress. An investment fund of £5m has been established to finance transformation projects which have a material, lasting and positive impact on the revenue budget.

4.5 Despite the good work and savings that are already complete, 2019/20 has been a year of further pressure on the revenue budget with an overspend still likely this year. But it is not true to say that savings have not been made as a result of LGR. The opposite is the case, as has been set out above and in previous

budget and monitoring reports. The overspends the Council is currently reporting are being caused by unprecedented levels of demand for social care services for children and adults and by investment in future services to help us live within reducing real levels of resource.

4.6 The Council must – and will – transform to deliver services sustainably within budget. But transformation takes time and the residents of Dorset need services to be delivered in the meantime. The council is using its reserves prudently during 2019/20 to support additional demand whilst transformation plans are developed for the longer term.

4.7 The experience of the first year of operation of the new Council has led to the development of three key principles which have underpinned the 2020/21 budget setting process:

a) a balanced budget which is not reliant on reserves

b) a realistic budget which is 'owned' by the directorates

c) balance achieved through efficiency not service cuts.

5. Directorate budget implications and resourcing

5.1 Overall, the Council's budget requirement shows an increase of approximately £10m from 2019/20. The summary movement is detailed in appendix 2a, and the budget proposals for individual directorates are detailed in the other parts of appendix 2.

5.2 It is important to note that the budget requirement is lower than the overall increase in expenditure as there are other sources of income and grant which reduce the increases in total spend to the increase in the budget requirement.

Children's Services (appendix 2b)

5.3 The Children's Services budget is under pressure in 2019/20, despite being increased by nearly £10m over the preceding year. In 2020/21, the budget is being increased by a further £10.3m, from £63.7m to £74.0m.

5.4 Additional resources are being put into the budget to provide for increasing levels and costs of support for children and young people with more complex needs. The Council is also examining how it might better use its capital budget to develop some of its own solutions to financial pressures caused by a limited national market where councils are competing for finite resources that can provide some of the services required.

5.5 As well as additional funding going in to support services, the directorate is also actively pursuing efficiency and reorganisation savings of £1.6m for the year.

Adults' Services & Housing (appendix 2c)

5.6 The budget for Adults' Services and Housing is similarly under strain, with unprecedented levels of demand coming through in the system. Again, the Council is able to make additional resources available to support older and more vulnerable people through the Adult Social Care Precept and additional funding being provided nationally by Government through the spending review and local government finance settlement.

5.7 The Adults' Services budget is being increased by £11.7m – from £111.2m to £122.9m. Again, despite these increases, the directorate is not static, with efficiencies of more than £1.2m being targeted.

Place Services (appendix 2d)

5.8 The Place Services budget is also predicted to overspend in 2019/20 but it is less subject to external demand and planning volatility than people-based services.

5.9 The budget strategy proposes to increase the base budget by £3.3m from £65.5m to £68.8m to take account of inflationary and contract pressures.

5.10 Despite this overall net increase, the directorate is progressing savings of £1.1m through improving the commercial offer, reorganisation and savings from reducing the Council's property portfolio.

Corporate Development (appendix 2e)

5.11 The Corporate Development budget is increasing by £1.7m from £31.9m to £33.6m. This is mainly due to employer pension cost increases and inflation on contracts.

5.12 Although the budget is increasing, this is after £7m of staff convergence costs have been removed and further savings on internal audit, external audit and other services have been achieved before those being delivered in 2020/21.

Contingency, capital financing and other central budgets (appendix 2f)

5.13 Central budgets reduce to reflect a lower level of contingency than in 2019/20, now that additional resources have been made available for directorate budgets. The additional £6m of grant funding is also shown in these lines.

5.14 Additional provision has been made for minimum revenue provision to support the capital programme set out in Appendix 4 and savings have also been made in the treasury management area referred to elsewhere in this report.

5.15 The Council is also progressing procurement and contract management savings using a one-council approach. These are being initiated through a series of workshops to address some of the themes raised in an external review commissioned by the predecessor councils.

5.16 As a result of its preparations for LGR, the Council already has a well-formed view of its spend, contractual arrangements and supplier relationships and it is

through initial review of this information for opportunities to review contracts as they fall due for renewal or renegotiation that this work will begin.

5.17 The Council is also seeking short-term financial benefits from its longer-term transformation work. The activity around the programme is set out later in this report.

6. Council tax strategy and recommendations

6.1 The Chancellor of the Exchequer presented the Government's one-year spending review on 4 September 2019 and an update was provided for Councillors following that announcement. At headline level, it was felt that there was some positive news for local government though the detail was unclear and therefore so was the impact on individual councils. What was apparent was that the social care precept would continue for 2020/21 at up to 2% of council tax. The referendum limit for increases to council tax (excluding the social care precept) was also confirmed at 2%.

6.2 As well as the increases in the headline rates of council tax and the social care precept, there is also an increase in the tax base each year. There are many factors involved in the calculation of the tax base growth, the most significant generally being the increase in the housing supply from newly built homes required to pay council tax for the first time. The "gross" increase in growth for 2020/21 is calculated as 0.46%, net growth 0.22%.

6.3 The yield from the increases in general council tax, tax base growth and the social care precept is approximately £10.2m.

6.4 Given the pressures that Dorset Council faces, for which the social care precept is specifically intended, Cabinet will be asked to agree and to recommend to Council that the general level of council tax is increased by 1.996% and that the full amount of social care precept of 2% is levied in 2020/21.

6.5 Cabinet will also be asked to confirm the planning assumption that annual increases of 2% in the general level of council tax are modelled into the Council's MTFP and financial strategy. The actual changes to Council Tax will be reviewed and agreed by the Council on an annual basis.

7. Further council tax considerations

7.1 At their meeting on 28th January, Cabinet will be asked to consider and approve a policy change which is intended to encourage owners of long-term empty properties to return these homes to use.

7.2 The Local Government Finance Act 2012 introduced amendments to the Local Government Finance Act 1992, allowing Councils to charge a 50% council tax premium, from 1 April 2013, on dwellings which had been unoccupied and unfurnished for at least two years. The premium is payable on top of the regular council tax charge.

7.3 The Act also provides that the following types of dwelling are exempt from the premium:

- dwellings which would be the sole or main residence of a person but which are empty whilst that person resides in accommodation provided by the Ministry of Defence by reason of their employment i.e. service personnel posted away from home
- dwellings which form annexes in a property which are being used as part of the main residence or dwelling in that property.

7.4 Government introduced legislation in 2018, providing Councils with the discretion to increase the premium to 100%, effective from 1 April 2019. The legislation also allows Councils to make further increases, as follows:

- to charge a council tax premium of 200%, effective from 1 April 2020, if the dwelling has been unoccupied and unfurnished for at least 5 years
- to charge a council tax premium of 300%, effective from 1 April 2021, if the dwelling has been unoccupied and unfurnished for at least 10 years.

7.5 All of the predecessor district councils determined that the 50% council tax premium should be charged on long-term empty properties, effective from 1 April 2013 and at its meeting on 20 February 2019, the Shadow Dorset Council determined that the premium should be increased to 100%, effective from 1 April 2019.

7.6 Council tax payers who are unhappy that a premium has been imposed in their case can apply for a council tax discretionary discount to be awarded. All applications for the discretionary discount are considered in line with the policy agreed by Cabinet at its meeting on 25 June 2019.

7.7 Dorset Council already charges a premium of 100% on properties that have been empty for longer than two years. Cabinet will receive a recommendation to extend the range of premiums to include the provisions set out in legislation from 2020 and 2021.

7.8 This means that from 1 April 2020 once a property has been empty for five years, a premium of 200% will be applied and from 1 April 2021 once a property has been empty for ten years, a premium of 300% will be applied.

7.9 At the date of writing this report, there are 176 properties that have been empty for at least two years. These changes would mean a further 54 that have been empty for more than five years, and 49 that have been empty for more than ten years would have higher premiums applied. The budget does not make any assumptions about the additional premiums becoming revenue for the council. The policy changes are intended to encourage owners of long-term empty properties to return these homes to use.

8. Transformation, sustainability and affordability

8.1 Cabinet approved the Transformation Plan on 4 November 2019. This is the long-term plan to transform the way we deliver services over the next five years. The Council's objective with this transformation plan is to bring whole-council projects into a coherent, joined-up approach to change, that meet the Council's

priorities, as set out in the Dorset Council Plan, and achieve our financial targets in the MTFP.

8.2 This will enable wider benefits to be realised than if managed through traditional, directorate silos. This will also provide bigger opportunities, by linking similar objectives in different services to maximise benefits across the system and make better use of the investment in terms of people, time, money and other resources required to effect change.

8.3 The plan sets out six themes for Transforming Dorset Council, which are:

- **One council service reform -** *rethinking our services and using co-design with our customers and partners*
- **Customer service -** *understanding customer experience and making services accessible*
- **Property and estate** - *delivering services in the right place by making best physical and financial use of our estate*
- **Travel and transport** - *improving integrated travel options for residents of all ages and in all communities*
- **Employer of choice** - *working together to maximise our workforce potential, shape our culture and help our people adapt to, and engage in, change*
- **Efficient organisation** - *modernising the way we work so we are leaner, digital and modern in the way we deliver services across the council.*

8.4 Following the approval by Cabinet, work is now under way to develop detailed delivery plans for these six themes, which will include some short-term savings as well as longer term benefits. A savings target of £3m has been set in the budget for 2020/21 from transformation activities. This is targeted in three priority areas where savings are most likely to be achieved in the next financial year. These are property rationalisation, travel and transport costs, and improved commissioning.

8.5 The detailed plans to achieve these aims are expected to be finalised by March 2020. This approach takes into account the capacity of the organisation to plan, resource and deliver significant transformational benefits across such a wide spectrum of services. It is unrealistic to expect all six themes to deliver concurrently, so these three areas are prioritised, with the others being developed for the longer term, but still within a five-year lifespan.

8.6 Overall, transformation is designed to deliver outcomes that improve the customer experience, and make the organisation more efficient and effective, as well as provide savings. However, in order to be financially resilient and sustainable in the long run, it is important to prioritise the financial gains in the shorter term.

8.7 A fund of £5m has been established to initiate work on priority projects that deliver financial returns in 2020/21. The final allocation of the fund sits with the

Leader, the Cabinet Member for Corporate Development and Change, and the Cabinet Member for Finance (the Transformation Board) in consultation with the Executive Director of Corporate Development and Chief Executive. A number of projects have already had funding approved, such as transport and asset management services, capital property purchase and residential hub refurbishment.

9. Capital programme, capital strategy and budget

9.1 The capital programme approved for 2019/20 was £65m. Slippage from 2018/19 for predecessor councils amounted to a further £37m giving a total capital programme of £102m. Approval of the 2019/20 programme also gave rise to contractual or constructive obligations for future years and it is that programme that Dorset Council continues to deliver as part of this budget strategy.

9.2 More detail of the previous programme is set out in Appendix 5 to the budget paper agreed by Shadow Council on 20 February 2019. That programme has been refreshed as set out below and is summarised in Appendix 4.

9.3 During 2019/20, Dorset Council established a Capital Strategy and Asset Management Group (CSAM) as an officer group charged with governance of the capital programme. This group reports to a sub-group of Cabinet to ensure the shaping of the programme fits the corporate plan themes, emerging priorities and is affordable.

9.4 CSAM also established a bidding process for 2020/21, to align capital funding to the Council's priorities and to ensure the programme delivers best value for Dorset residents. As part of this alignment of resources with priorities, the group also reviewed the current capital programme of £102m to ensure the full programme for 2020/21 was reviewed as part of the budget and MTFP process.

9.5 The review of the current programme was steered by the sources of funding in much the same way as the Budget Working Group developed the 2019/20 capital programme. This involved classification of the programme into three categories:

- projects that are fully-funded from external sources e.g. DfT grant. These projects received a relatively lighter-touch review to ensure funds were being spent in accordance with the grant conditions and were spent on highest priority projects giving best value and outcomes.
- Projects that were partially funded from external sources eg partial grant funding, S106 agreements etc. These projects received an intermediate level of scrutiny to ensure that the Council was still getting best value from the contribution made from its own resources as well as securing optimum levels of external contribution for the projects chosen.
- Projects that are fully-funded from the Council's own resources. These projects received detailed scrutiny and challenge to ensure they were giving

best value, were affordable and were still aligned to the emerging Dorset Council corporate plan, themes and objectives.

9.6 The review enabled approximately £7m to be released from the 2019/20 programme, due to underspends or projects stalling or no longer being required.

9.7 In developing the 2020/21 programme it has also been necessary to include new year requirements for rolling programmes of work that were not in the capital programme beyond year 1 for 2019/20. No new bids were allowed in that budget build, so programmes that were essentially treated as one-off in nature but were in fact, an annual requirement (such as property maintenance or replacement of the IT estate).

9.8 For 2020/21 as mentioned, CSAM established a bidding process. However, the bidding process mentioned above has not yet concluded so no new projects are included in the programme at this stage. There is however, £15m of unallocated funding, affordable within the capital financing provision in the revenue budget, which will be allocated to new projects according to their strategic fit with the objectives of the Council's capital strategy and payback during 2020/21. Decisions about which projects proceed will be considered by Cabinet from January 2020.

9.9 At this stage it is not clear how much of the capital programme will slip from 2019/20 into 2020/21 but the base budget already provides for funding of that programme.

10. Treasury management strategy

10.1 The proposed treasury management strategy is attached at Appendix 6 and will be put forward for Cabinet's approval and subsequent recommendation to Council.

10.2 In building the budget for 2019/20, the Council took advantage of opportunities to rationalise some of its investments and borrowing and also to develop its investment strategy, involving the support of Arlingclose, a new treasury adviser that was appointed after a competitive procurement process.

10.3 This resulted in an improvement of £2m in the treasury budget and further work carried out in the current year means that a further improvement of £0.75m is incorporated into the 2020/21 budget.

10.4 The Council continues to pursue opportunities to improve its treasury performance, but it must also be mindful of risk and volatility. One example of this is the recent change to the Public Works Loan Board (PWLB) borrowing rate which increased overnight by 1% with no clear warning that it was likely to happen.

10.5 During 2019/20 the Council also tendered for a new provider of banking services as predecessor Councils had different bankers. The outcome, moving to a single banking provider, is likely to deliver savings in excess of £70k per annum. This is

a further example of the financial benefits achieved through local government reorganisation.

11. Consultation, communication and equality matters

11.1 Dorset Council's 2019/20 budget was approved by the Shadow Council in February 2019. Members were elected to the Council in May 2019 and a series of financial briefings were included in their induction. Members have continued to be updated on the Council's financial performance through quarterly reports to Cabinet.

11.2 In October 2019 the draft Dorset Council Plan was published which identified the Council's proposed service and financial priorities. Conversations have been held with partners, the public, Town and Parish Councils, employees and other stakeholders throughout Dorset and there have been over 1,800 responses. These responses have informed the Dorset Council Plan, which has in turn influenced the shaping of the 2020/21 budget proposals and MTFP.

12. Reserves, balances, contingency and resilience

12.1 The balance of the general funds of predecessor councils at 31 March 2019 was £30.2m. The disaggregation of the County Council portion of this resulted in £2.1m passing to BCP Council meaning that £28.1m is available to Dorset Council. Any overspend in the current year will create a draw on the general fund unless it is financed from other reserves.

12.2 In 2018 the shadow Council commissioned an independent report from the Charted Institute of Public Finance and Accountancy (CIPFA) which recommended that the Council should retain as a minimum, 5% of its budget requirement as a general fund reserve. Cabinet is therefore recommended to agree a minimum level for the general fund of £15m; a very modest increase over the £14m agreed in the last budget paper. The increases in directorate budgets and the convergence of balance sheets means there should be less risk to the general reserve, so this also supports the small increase proposed to the minimum level.

12.3 The closing balances of earmarked reserves of the predecessor councils is also being reviewed and as part of the process of closing this year's accounts, some benchmarking work is also being carried out to understand the level of reserves carried by similar councils.

12.4 The work so far indicates that Dorset Council will be able to establish a prudent level of earmarked reserves and will work towards releasing some of these for investment in future service capacity and improvement once the direction of future funding from Central Government is clearer.

12.5 The Department for Education consulted during the year about DSG overspends. Councils have consistently campaigned to have these overspends addressed nationally by the Treasury. The consultation suggested that councils would be

specifically precluded from funding DSG overspends themselves without the express approval of the Secretary of State. DSG overspends will required to be carried forward rather than financed by councils. The DfE is also working with Dorset and other councils nationally to support the return of the DSG to balance over a period of time which will also enable the cumulative DSG overspend being carried by the council to be repaid.

12.6 It is prudent for any organisation to set a contingency budget to provide for unforeseeable circumstances arising during the year. The key is to set the contingency budget as accurately as possible, so it strikes a good balance between allowing the organisation to manage risk whilst not causing a diversion of material funds away from front line services where there are clearly, continuing pressures.

12.7 The level of the general fund balance, the raising of the lower limit, the additional funding being put into directorate budgets and the review and consolidation of the Council's reserves will all strengthen the organisation's resilience. A further piece of work is currently being undertaken as part of the review of the Council's resilience indicators as published by CIPFA.

13. Summary/conclusions

13.1 Whilst Dorset Council is entering its second year with a reasonable underlying financial position, expenditure pressures in the Adults and Children's services are of significant concern. The 2019/20 overspend is supported by reserves.

13.2 The 2020/21 budget proposals allow for significant increase in budget for Children's and Adults services through a combination of increased government funding, increased contributions from local residents and efficiencies which continue to be realised following the creation of a Unitary Council.

13.3 The Council is putting increased emphasis on transformation programmes to deliver longer term service change and efficiencies, and considerable progress will need to be made in 2020/21.

13.4 The robustness of the budget critically depends on the maintenance of a sound financial control environment including effective financial management in each of the Council's service directorates, and this will be a priority in 2020/21.

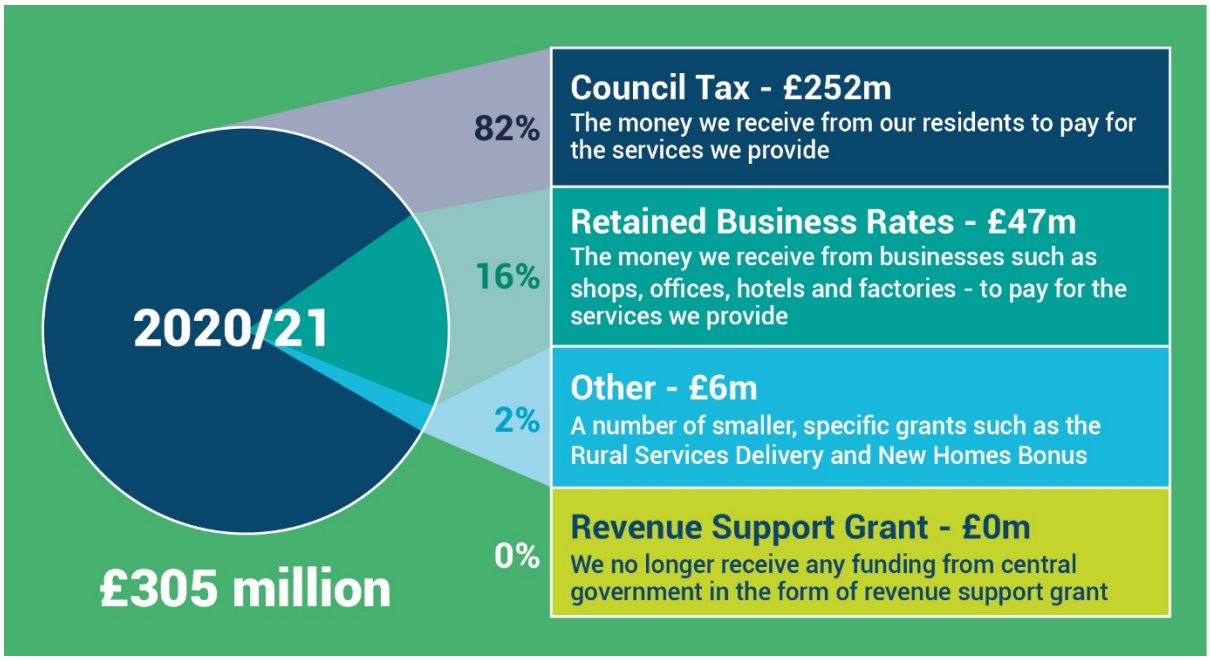
13.5 The Council is taking a long-term view of its financial planning through the development of the MTFP. However, the 'one year at a time' nature of the government's current spending announcements means that is difficult to predict in the medium term with any degree of confidence. This, combined with potential for unforeseen and unpredictable demand for high costs services creates a difficult financial environment for the Council to plan its activities. The Council will need to be increasingly forward looking, agile and responsive as it seeks to

balance its responsibilities to residents and service users with its responsibility to the local taxpayer.

Aidan Dunn

Executive Director, Corporate Development

Appendix 1 – Sources of Funding



Appendix 2 – Summary Budget proposals

2a – overall Dorset Council

Dorset Council - 2020/21 Budget Summary

Service	2019/20 Current Base Budget	Overspend	Inflation	Demand/ Pressures	Savings/ funding	2020/21 Original Base Budget
People - Adults & Housing	111,238,855	5,500,000	1,549,630	5,889,408	-1,240,000	122,937,893
Corporate Development	31,886,909		825,777	979,100	-63,363	33,628,423
Place	65,450,994		1,393,602	2,996,825	-1,070,000	68,771,421
People - Children's	63,695,190	8,500,000	1,621,085	1,737,283	-1,600,000	73,953,558
Public Health	0					0
Contingency, capital financing and other central budgets	22,766,841	-3,500,000		-2,950,428	-10,302,979	6,013,434
Total	295,038,789	10,500,000	5,390,094	8,652,188	-14,276,342	305,304,729

2b – Children's Services

	£
Opening Base Budget 19/20	63,695,190
Add in Overspend	8,500,000
Inflation	1,621,085
LGPS Adjustment	357,200
Graduate Placements	17,500
Increase in growth of LAC	835,583
Increase in EHCP's - transport	527,000
Impact of new delivery model	(250,000)
Contact Service	(150,000)
Blueprint for Change	(450,000)
Health Contributions to Placements	(400,000)
Contract reductions (19/20 full-year)	(150,000)
5% contract reductions for 2020/21 renewals	(200,000)
Proposed 2020/21 Base Budget	73,953,558

Inflation Factors
(Pay award 2.75%, CPI 1.2%, Income 2.3%)

2c – Adults' Services & Housing

	£
Opening Base Budget 19/20	111,238,855
Social Care Precept	4,826,902
Add in additional pressures from overspend	673,098
Inflation	1,549,630
LGPS Adjustment	275,100
Graduate Placements	17,500
Adult care packages	5,496,808
RCCO adjustment for equipment	100,000
Care package savings	(800,000)
Assistive technology	(300,000)
Housing restructure	(40,000)
Brokerage	(100,000)
Proposed 2020/21 Base Budget	122,937,893

Inflation Factors
(Pay award 2.75%, CPI 1.2%, Income 2.3%)

2d – Place

	£
Opening Base Budget 19/20	65,450,994
Inflation	1,393,602
Graduate Placements	17,500
LGPS Adjustment	1,015,500
Highways flooding	7,100
DWP budget pressures	1,125,000
Coroners Office pressure	300,000
Property costs not within budget	433,000
Streetlighting PFI changes	80,725
Loss of nature nursery	18,000
Reduction of libraries book fund	(75,000)
Parking charges early agreement to transition alignment	(300,000)
Property holding costs - bring forward disposal of properties	(500,000)
Restructure of CSU & libraries	(45,000)
Waste efficiency savings	(50,000)
Reduction in TIC subsidy	(100,000)
Proposed 2020/21 Base Budget	68,771,421

Inflation Factors
(Pay award 2.75%, CPI 1.2%, Income 2.3%)

2e – Corporate Development

	£
Opening Base Budget 19/20	31,886,909
Inflation	825,777
Graduate Placements	17,500
Transfer of support recharges	61,700
LGPS adjustment	554,900
Transfer of posts within RCCO to IT	345,000
Audit savings	(43,363)
Early retirement costs	(20,000)
Proposed 2020/21 Base Budget	33,628,423

Inflation Factors
(Pay award 2.75%, CPI 1.2%, Income 2.3%)

2f – Contingency, capital financing and other central budgets

	£
Opening Base Budget 19/20	22,766,841
Transformation savings	(3,000,000)
Procurement & contract management savings	(3,000,000)
Net change in contingency required to support base changes	(1,796,412)
LGPS Adjustment	(1,642,000)
RCCO rebasing	(1,482,595)
Changes in grant funding	(5,995,400)
MRP increase in capital programme	913,000
Treasury management improvements	(750,000)
Proposed 2020/21 Base Budget	6,013,434

Inflation Factors
(Pay award 2.75%, CPI 1.2%, Income 2.3%)

Appendix 3 - Summary of MTFP assumptions

	2020/21	2021/22	2022/23	2023/24	2024/25
Council tax increase	<2%	<2%	<2%	<2%	<2%
Social Care Precept	2%	0%	0%	0%	0%
Business rates growth	0%	0%	0%	0%	0%
Pay award	2.75%	2.50%	2.25%	2%	2%
General inflation	1.20%	2.25%	2.50%	2.50%	2.50%
Increase in fees & charges	2.30%	2.25%	2.50%	2.50%	2.50%
Employer pension contribution	2% +£650k	0% +£252k	0% +£261k	£750k	£275k
Adult Services pressures	£5,497k	£5,109k	£5,333k	£5,585k	£5,827k
Children's Services pressures	£1,362k	£1,127k	£1,046k	£967k	£1,015k
Base budget pressures from 2019/20	£10,500				

Summary budget gap (£000)	0	7,461	5,418	6,834	5,537
Cumulative budget gap (£000)	0	7,461	12,879	19,712	25,249

Appendix 4 – Capital

Dorset Council Draft Capital Programme 2020/21 and beyond
Appendix 4(i) - projects with full external funding

	2019/20 £000	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000	2024/25 £000	20/21-24/25 Total £000
Funding source							
Capital grant DfT/DfE/other	(21,485)	(14,127)	(15,101)				(50,713)
Growth deal/developer/S106 contributions	(13,693)	(3,905)					(17,598)
Total funding	(35,178)	(18,032)	(15,101)	0	0	0	(68,311)
Projects							
Local Transport Plan programme of works	21,485	14,127	15,101				50,713
Longham Mini Roundabouts	10	1,655					1,665
Parley West Link	2,269	2,250					4,519
Parley East Link	2,000						2,000
Chesil Sea Wall Study (WPBC)	63						63
Weymouth BMS	26						26
Weymouth Breach Analysis	5						5
Weymouth Tidal Defence scheme	73						73
Harbour Walls Condition survey	27						27
Weymouth Promenade Artistic Lighting	177						177
Lyme Regis Environmental Plan phase 4	281						281
West Bay Protection works	1						1
Gillingham Growth Deal	1,871						1,871
Durlston Pleasure Grounds	569						569
Ultrafast Broadband	3,900						3,900
Superfast Broadband Phase 3	2,000						2,000
Superfast Broadband Phase 4	421						421
Total spend	35,178	18,032	15,101	0	0	0	68,311
Net expenditure	**0**	**0**	**0**	**0**	**0**	**0**	**0**

Dorset Council Draft Capital Programme 2020/21 and beyond
Appendix 4(ii) - projects with partial external funding

	2019/20 £000	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000	2024/25 £000	20/21-24/25 Total £000
Funding source							
Section 106 Agreements/Contributions/Growth Deal	(1,877)						(1,877)
Capital grant DfT/DfE/other	(6,636)	(9,400)	(3,891)				(19,927)
Contribution from MHCLG (Blandford)		(2,500)					(2,500)
Total funding	(8,513)	(11,900)	(3,891)	0	0	0	(24,304)
Projects							
Parley Cross	1,354						1,354
Dorset History Centre original bid	77	665	2,334	165			3,241
Dorset Innovation Park	3,623						3,623
DWP Infrastructure - Blandford site	642	7,408	1,948	2,902			12,900
Schools Basic Need programme	12,316	5,417	4,491				22,224
Relocatable Housing	2,045	170					2,215
Lyme Regis Environmental Plan phase 5	2,300						2,300
Total spend	22,357	13,660	8,773	3,067	0	0	47,857
Net expenditure	**13,844**	**1,760**	**4,882**	**3,067**	**0**	**0**	**23,553**

Dorset Council Draft Capital Programme 2020/21 and beyond
Appendix 4(iii) - projects with no external funding

	2019/20 £000	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000	2024/25 £000	20/21-24/25 Total £000
Projects							
Schools Access Initiative	100	200	200	200	200		900
Relocation of Dorchester Learning Centre	54						54
Children's minor capital works	200						200
Children's modular urgent works programme	79						79
Weymouth Relief Road	1,268	1,574					2,842
E&E minor capital works	235						235
Bridport Gateway	1,196	135					1,331
Libraries minor capital works	25						25
County Buildings minor capital works	117						117
ICT minor capital works and projects	3,185	750	750	750	750	750	6,935
Development Schemes/Corporate Initiatives	368						368
Property Minor Works & Feasibilities	3						3
Chief Executives Special Projects	127						127
Property Improvements Programme	6,308	6,000	6,000	6,000	6,000	6,000	36,308
Dorset Council Fleet Replacement Programme	4,290	4,106	4,781	2,983	6,024	5,770	27,954
Bins and containers for waste services	597	595					1,192
Weymouth Peninsula including Harbour Walls (W&PBC)	3,500	6,000	4,946				14,446
Beaucroft	993						993
DTEP	40						40
Springfield Distributor Road	1						1
Dinahs Hollow	2						2
A338	4						4
Superfast Broadband Phase 1	1,828						1,828
Raise/Mosaic	796						796
DMISC	60						60
Countywide Office Accomm	265						265
Living & Learning	200						200
Weymouth Library	405						405
Weymouth Harbour Walls	673						673
Weymouth Public Conveniences	469						469
North Quay redevelopment	63						63
High Street Fortuneswell	128						128
Weymouth Pavillion improvement grant	12						12
Demolition of Ferry Terminal A	282						282
Dorchester Retail scheme/Dorchester Development/parking	810						810
West Bay Deep Water Berth design	305						305
Lyme Regis Environmental Plan phase 5 feasibility	79						79
Lyme Regis Harbourmasters Office	255						255
West Bay Coastal Improvements	2,835						2,835
Blandford Leisure Centre	16						16
Housing Projects ex DCP	3,800						3,800
Vehicle Loan repayment (DCP)	86						86
Dorchester Sports Centre Artificial Pitch	180						180
Corfe Castle Village Hall grant	20						20
Norden Car Park Refurbishment	56						56
Proposed footbridge River Allen	11						11
Car Park Ticket Machines	25						25
Cashmoor Sewage Treatment Works	81						81
Wimborne Riverside	1						1
Potterne Tennis Courts	6						6
Housing Projects ex EDDC	1,000						1,000
The Barrington Centre	549						549
EDDC Transformation Programme	26						26
MVCP Grounds Maintenance Depot	170						170
Allendale Community Centre	335						335
Heatherlands Community Facility	45						45
Ferndown Community Centre Roof	11						11
Investment fund		15,000					15,000
Total spend	38,575	34,360	16,677	9,933	12,974	12,520	125,039
Net expenditure	**38,575**	**34,360**	**16,677**	**9,933**	**12,974**	**12,520**	**125,039**

Dorset Council Draft Capital Programme 2020/21 and beyond
Appendix 4(iv) - summary of net expenditure and funding

	2019/20 £000	2020/21 £000	2021/22 £000	2022/23 £000	2023/24 £000	2024/25 £000	20/21-24/25 Total £000
Total expenditure	**96,110**	**66,052**	**40,551**	**13,000**	**12,974**	**12,520**	**241,207**
Full external funding	(35,178)	(18,032)	(15,101)	0	0	0	(68,311)
Partial external funding	(8,513)	(11,900)	(3,891)	0	0	0	(24,304)
Dorset Council part funding (borrowing)	(13,844)	(1,760)	(4,882)	(3,067)	0	0	(23,553)
Dorset Council funding (borrowing)	(14,930)	(21,836)	(3,341)	4,108	1,291	1,713	(32,994)
Dorset Council funding (Reserves/Unapplied capital receipts)	(6,050)	0	0	0	0	0	(6,050)
Dorset Council funding (New capital receipts)	0	0	0	0	0	0	0
Dorset Council funding (DWP)	(2,861)	(3,028)	(3,250)	(3,750)	(4,000)	(4,000)	(20,889)
Dorset Council funding (reserves)	(1,108)	0	0	0	0	0	(1,108)
Dorset Council funding (revenue contributions)	(4,889)	0	0	0	0	0	(4,889)
Minimum Revenue Provision	(8,737)	(9,496)	(10,086)	(10,291)	(10,265)	(10,233)	(59,109)
Total funding	**(96,110)**	**(66,052)**	**(40,551)**	**(13,000)**	**(12,974)**	**(12,520)**	**(241,207)**

Appendix 5 – Capital Strategy

1. Introduction

1.1 This capital strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability.

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

2. Capital Expenditure and Financing

2.1 Capital expenditure is where the Council spends money on assets, such as property or vehicles, that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Council has some limited discretion on what is treated as capital expenditure, for example, land and building assets costing less than £25k are generally not capitalised and are instead charged to revenue in the year of purchase.

2.2 In 2020/21, the Council is planning capital expenditure of £66m as detailed in Appendix 4 and summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £ millions

	2019/20 Forecast	2020/21 Budget	2021/22 Budget	2022/23 Budget
Projects with full external funding	35	18	15	0
Projects with partial external funding	22	14	9	3
Projects with no external funding	39	34	17	10
Total	**96**	**66**	**41**	**13**

2.3 The introduction of International Financial Reporting Standard (IFRS)16 Leases for the 2020/21 financial year, requires all 'right of use' assets to be shown on the balance sheet. The impact of this change in accounting treatment is currently being established.

2.4 Service managers bid annually for approval of capital projects. Following completion of the 2020/21 bidding round, Cabinet will not be considering any new bids as part of the budget process. Instead, a sum of £15m has been set aside as an investment fund against which new bids can be submitted in the new financial year.

2.5 Bids are collated by the Finance Policy & Compliance Finance team who calculate the financing cost (which can be nil if the project is fully externally financed). The Capital Strategy and Asset Management Group (CSAMG) appraises all bids based on a comparison of service priorities against financing costs and makes proposals to Cabinet. The final capital programme is then presented to Cabinet and then Council for approval.

2.6 Capital projects with the most beneficial impact on the revenue budget will be prioritised. The Council also intends to repurpose assets for better service delivery.

2.7 All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is set out in detail in Appendix 4 and summarised below:

Table 2: Capital Financing in £ millions

	2019/20 Forecast	**2020/21 Budget**	**2021/22 Budget**	**2022/23 Budget**
Grants and contributions	43	30	19	0
Dorset Waste Partnership (DWP)	3	3	3	4
Capital receipts	6	0	0	0
Reserves	1	0	0	0
Minimum Revenue Provision (MRP)	9	9	11	10
Other revenue contributions	5	0	0	0
Debt	29	24	8	-1
Total	**96**	**66**	**41**	**13**

2.8 Debt is only a temporary source of finance, since loans and leases must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace debt finance.

2.9 The Council's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and capital receipts used to replace debt. The CFR is expected to increase by £14m during 2020/21. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 3: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

	31-Mar 2019 Actual	31-Mar 2020 Forecast	31-Mar 2021 Budget	31-Mar 2022 Budget	31-Mar 2023 Budget
Capital Financing Requirement	308	337	361	369	368

2.10 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. The Council is currently also permitted to spend capital receipts on service transformation projects until 2022/23. The Council plans to receive £24m of capital receipts in 2020/21 as follows:

Table 4: Capital receipts receivable in £ millions

	2019/20 Forecast	2020/21 Budget	2021/22 Budget	2022/23 Budget
Asset sales	7	24	0	0

2.11 The capital programme does not assume any application of capital receipts as financing beyond 2019/20 at this stage. A decision about the use of capital receipts will be taken by Cabinet in 2020/21 as they can either be used to finance new capital expenditure, or flexibly to finance revenue transformation costs.

3. Treasury Management

3.1 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, to avoid excessive credit balances or overdrafts in the bank current account.

3.2 Each of Dorset Council's six predecessor councils had different balance sheets and different capital programmes, and each had therefore developed different treasury management strategies to suit their individual circumstances. For example, the old county council had a relatively high borrowing requirement, so it prioritised reducing the cost of debt by using reserves and balances to 'offset' this borrowing need in order to reduce counterparty risk and keep interest costs low. In contrast, the district and boroughs tended to have relatively low (or no) borrowing requirements, so their strategies focused on using reserves and balances to generate higher returns from their investment portfolios.

3.3 Dorset Council now needs to develop its own treasury management strategy to meet the needs of its combined balance sheet and capital programme. Existing borrowing and investment positions will need to be reviewed, and changed if necessary, to

achieve an appropriate balance between cost and risk.

Borrowing Strategy

3.4 The Council's main objectives when borrowing are to achieve a low and certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between relatively inexpensive short-term loans (currently available at annual interest rates of approximately 0.75%) and long-term fixed rate loans where the future cost is known but higher (currently available at annual interest rates of approximately 2.0% to 3.0%).

3.5 Projected levels of the Council's total outstanding debt (which comprises borrowing, PFI liabilities, leases) are shown below, compared with the capital financing requirement.

Table 5: Prudential Indicator: Capital Financing Requirement and Gross Debt in £ millions

	31-Mar 2019 Actual	31-Mar 2020 Forecast	31-Mar 2021 Budget	31-Mar 2022 Budget	31-Mar 2023 Budget
Capital Financing Requirement	**308**	**337**	**361**	**369**	**368**
External Debt (incl. PFI & leases):					
External borrowing	233	240	240	240	240
Long Term PFI Liabilities	25	25	25	25	25
Obligations under Finance Leases	5	5	5	5	5
Total Debt	**263**	**270**	**270**	**270**	**270**
Internal Borrowing	**45**	**67**	**91**	**99**	**98**

3.6 Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. The Council expects to comply with this requirement in the medium term, as shown in the table above.

3.7 To compare the Council's actual borrowing against an alternative strategy, a 'liability benchmark' has been calculated showing the lowest possible level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £20m at each year-end.

Table 6: Borrowing and the Liability Benchmark in £ millions

	31-Mar 2019 Actual	31-Mar 2020 Forecast	31-Mar 2021 Budget	31-Mar 2022 Budget	31-Mar 2023 Budget
Outstanding borrowing	233	240	240	240	240
Liability benchmark	108	160	160	160	160
Difference	125	80	80	80	80

3.8 The table above shows that the Council expects to remain borrowed above its liability benchmark by approximately £80m over the medium term.

3.9 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 the authorised limit.

Table 7: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2019/20 Forecast	2020/21 Budget	2021/22 Budget	2022/23 Budget
Authorised Limits:				
Borrowing	360	380	390	390
PFI and leases	35	35	35	35
Total External Debt	**395**	**415**	**425**	**425**
Operational Boundary:				
Borrowing	380	400	410	410
PFI and leases	40	40	40	40
Total External Debt	**420**	**440**	**450**	**450**

3.10 The authorised limit and operational boundary for 2020/21 and subsequent years may need to be reviewed when the impact of the changes in accounting for leases under IFRS 16 are more fully understood.

Treasury Investments Strategy

3.11 Treasury investments arise from receiving cash before it is paid out again. Investments made for service or commercial reasons are not generally considered to be part of treasury management (see paragraphs 4 and 5 below).

3.12 The Council's policy on treasury investments is to prioritise security and liquidity over yield, that is 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.

3.13 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.

Table 8: Treasury investments in £millions

	31-Mar 2019 Actual	31-Mar 2020 Forecast	31-Mar 2021 Budget	31-Mar 2022 Budget	31-Mar 2023 Budget
Short term investments	65	20	20	20	20
Long term investments	80	80	80	80	80
Total Investments	**145**	**100**	**100**	**100**	**100**

3.14 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.

3.15 Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Section 151 Officer and staff, who must act in line with the treasury management strategy approved by Council each year. The Audit and Governance Committee is responsible for scrutinising treasury management decisions, and regular reports on treasury management activity are presented to this committee.

3.16 The Council's treasury management strategy includes further details of the Council's borrowing and treasury investments.

4. Investments for Service Purpose

4.1 The Council may make investments to assist local public services, including making loans to or investing in local service providers, including its own subsidiaries. In light of the public service objective, the Council may be willing to take more risk than with treasury investments, however it still plans for such investments to break even after all costs.

4.2 Decisions on service investments must be made in line with the criteria and limits laid down in the investment strategy to be approved by Council.

5 Commercial Activities

5.1 The Council may invest in property or other commercial activities purely or mainly for financial gain. As financial return is the main objective, the Council may accept a higher level of risk on commercial investments than with treasury investments. The value and risks of commercial investments must remain proportionate to the

size of the Council, and contingency plans must be put in place should expected yields not materialise.

5.2 Dorset Council has 'inherited' from the predecessor councils a number of assets, such as hotels in Weymouth, that could be considered to be held primarily for commercial return. These holdings, and their accounting treatment, will need to be reviewed.

5.3 Decisions on commercial investments are made by in line with the criteria and limits in the investment strategy to be approved by Council.

6. Revenue Budget Implications

6.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. Estimated financing costs are summarised in the table below:

Table 9: Estimated financing costs in £ millions

	2019/20 Forecast	2020/21 Budget	2021/22 Budget	2022/23 Budget
Interest Payable	9.5	9.2	9.2	9.2
Minimum Revenue Provision (MRP)	9.0	9.0	11.0	10.0
Gross Financing Costs	**18.5**	**18.2**	**20.2**	**19.2**
Less Investment Income	-3.6	-3.8	-3.8	-3.8
Net Financing Costs	**14.9**	**14.4**	**16.4**	**15.4**

6.2 The table below compares estimated financing costs to the Council's estimated net revenue stream i.e. the amount funded from council tax, business rates and general government grants.

Table 10: Prudential Indicator: Proportion of financing costs to net revenue stream

	2019/20 Forecast	2020/21 Budget	2021/22 Budget	2022/23 Budget
Financing costs (£m)	15	14	16	15
Proportion of net revenue stream	5.1%	4.6%	5.2%	4.8%

6.2 Financing costs for 2020/21 and subsequent years will need to be reviewed when the impact of the changes in accounting for leases under IFRS 16 are more fully understood.

6.3 Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years may extend many

years into the future. The Section 151 Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable.

7. Knowledge and Skills

7.1 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. The Council supports junior staff to study towards relevant professional qualifications.

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

Appendix 6

Treasury Management Strategy

1. Introduction

1.1 Local authorities operate a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. The role of treasury management is to ensure this cash flow is adequately planned, with surplus monies invested with low risk counterparties, ensuring adequate liquidity initially before then considering optimising investment return.

1.2 The second main function of the treasury management service is the funding of capital plans. These capital plans provide a guide to the borrowing needs of councils, essentially longer-term cash flow planning to ensure capital spending requirements can be met. This management of longer-term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. Also, on occasion, any debt previously drawn may be restructured to meet risk or cost objectives.

1.3 Accordingly, treasury management is defined by the Chartered Institute of Public Finance and Accountancy (CIPFA) as:
"The management of the local Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.4 The Council has adopted CIPFA's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code). The Code recommends that local authorities produce for each financial year, as a minimum:

- An annual strategy in advance of the year (this report);
- A mid-year update describing activity for the year to date compared to the strategy; and;
- An annual review of activity following the end of the year.

2. Treasury Management Advisers

2.1 The Council employs professionally qualified and experienced staff with responsibility for making borrowing and investment decisions. Officers are supported by external advisers who are specialists in their fields. The Council currently employs Arlingclose Limited as treasury management advisers.

2.2 This approach ensures that the Council has access to a wide pool of relevant market intelligence, knowledge and skills, that would be very difficult and costly to replicate internally. However, whilst advisers provide support to the internal treasury function, final decisions on treasury matters always remain with the Council.

3. External Context (Economic Background and Outlook)

3.1 Treasury management decisions made by the Council must take into consideration

external factors, particularly the wider economic backdrop and the outlook for financial markets and interest rates.

3.2 Arlingclose are forecasting that Bank Rate will remain at 0.75% until the end of 2022. A detailed economic commentary and interest rate forecast provided by Arlingclose is provided in Annex 1.

4. Local Context

4.1 Each of Dorset Council's six predecessor councils had different balance sheets and different capital programmes, and each had therefore developed different treasury management strategies to suit their individual circumstances. For example, the former county council had a relatively high borrowing requirement, so it prioritised reducing the cost of debt by using reserves and balances to 'offset' this borrowing need in order to reduce counterparty risk and keep interest costs low. In contrast, the district and boroughs tended to have relatively low (or no) borrowing requirements, so their strategies focused on using reserves and balances to generate higher returns from their investment portfolios.

4.2 Dorset Council now needs to develop its own treasury management strategy to meet the needs of its combined balance sheet and capital programme. Existing borrowing and investment positions will need to be reviewed, and changed if necessary, to achieve an appropriate balance between cost and risk.

4.3 The Council's balance sheet summary and forecast are shown in table 1 below.

Table 1: Balance Sheet summary in £ millions

	01-Apr 2019 Actual	31-Mar 2020 Forecast	31-Mar 2021 Budget	31-Mar 2022 Budget	31-Mar 2023 Budget
Capital Financing Requirement	**308**	**337**	**361**	**369**	**368**
External Debt (incl. PFI & leases):					
External borrowing	233	240	240	240	240
Long Term PFI Liabilities	25	25	25	25	25
Obligations under Finance Leases	5	5	5	5	5
Total External Debt	**263**	**270**	**270**	**270**	**270**
Internal Borrowing	45	67	91	99	98
Cash and Investments	**148**	**100**	**100**	**100**	**100**

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

4.5 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 1 shows that the Council expects to comply with this recommendation over the medium term.

4.6 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 1 above, but that cash and investment balances are kept to a minimum level of £20m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 2: Liability Benchmark in £ millions

	01-Apr 2019 Actual	31-Mar 2020 Forecast	31-Mar 2021 Budget	31-Mar 2022 Budget	31-Mar 2023 Budget
Outstanding borrowing	233	240	240	240	240
Liability benchmark	108	160	160	160	160
Difference	125	80	80	80	80

5 Borrowing Strategy

5.1 As at 31 December 2019, the Council held £222.5 million of loans as part of its strategy for funding this year's and previous years' capital programmes. Outstanding loans at 31 December 2019 are summarised in Table 3 below.

Table 3: Borrowing Position

	31.03.19 Balance £m	Net Movement £m	31.12.19 Balance £m	31.12.19 Average Rate %	31.12.19 Average Maturity (years)
Public Works Loan Board	86.4	0.0	86.4	4.0	17.7
Banks (fixed-term)	25.6	0.0	25.6	4.7	57.1
Banks (LOBO)	31.0	-20.0	11.0	4.6	56.6
Local authorities (long-term)	15.0	0.0	15.0	4.4	39.7
Local authorities (short-term)	30.0	-10.0	20.0	0.8	0
Other lenders (fixed-term)	25.0	20.0	45.0	3.3	45.7
Other lenders (LOBO)	19.5	0.0	19.5	2.6	12.6
Total Borrowing	**232.5**	**-9.9**	**222.5**	**3.7**	**28.3**

5.2 The chief objective of the Council (and its predecessors) when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should long-term plans change being a secondary objective.

5.3 With short-term interest rates remaining much lower than long-term rates, the Council considers it to be more cost effective in the near term to use internal resources or borrow rolling short-term loans instead. This strategy has enabled the Council to reduce net borrowing costs (despite foregone investment income) and to reduce overall treasury risk. The Council's borrowing decisions are not predicated on any one outcome for interest rates and a balanced portfolio of short and long-term borrowing has been maintained.

5.4 The benefits of internal and/or 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.

5.5 The predecessor councils had previously raised a significant proportion of their long-term borrowing from the PWLB but the government increased PWLB rates by 1% in October 2019 making it now a relatively expensive option. The Council will now look 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.

5.6 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. In addition, the Council may borrow short-term loans to cover unplanned cash flow shortages.

5.7 The Council's 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 sector pension funds (including the Dorset County Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local Council bond issues

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

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

5.9 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.

5.10 The Council holds £30.5m of Lender's Option Borrower's Option (LOBO) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. £11m of these LOBOs have options during 2020/21, and although the Council believes that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

5.11 Short-term and variable rate loans leave the Council 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).

5.12 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.

6. Investment Strategy

6.1 The Council holds significant levels of invested funds, representing income received in advance of expenditure plus balances and reserves held. Cash, cash equivalents and investments held on 30 September 2019 are summarised in Table 4 below.

Table 4: Treasury Investments Position

	31.03.19 Balance £m	Net Movement £m	30.09.19 Balance £m	2019/20 Income Return (p.a.)
Cash and Cash Equivalents:				
Banks & Building Societies (unsecured)	46.2	-36.1	10.1	0.40%
Covered bonds (secured)	0.0	0.0	0.0	0.00%
Government (including local authorities)	19.4	5.7	25.1	0.50%
Corporate bonds and loans	0.0	0.0	0.0	0.00%
Money Market Funds	33.7	-2.1	31.5	0.73%
Less 'co-mingled' Dorset LEP Balances*	-32.3	-3.8	-36.1	0.40%
Total Cash and Cash Equivalents	**67.0**	**-36.4**	**30.6**	**0.82%**
Investments:				
Short-dated bond funds	3.0	0.0	3.0	1.97%
Strategic bond funds	10.7	0.2	10.9	2.30%
Equity income funds	42.0	0.0	42.0	2.89%
Property funds	18.1	2.2	20.4	2.28%
Multi asset income funds	6.7	0.0	6.7	4.55%
Real Estate Investment Trusts (REITS)	0.0	0.0	0.0	0.00%
Total Investments	**80.5**	**2.5**	**83.0**	**2.77%**
Total Cash and Investments	**147.5**	**-33.9**	**113.6**	**2.24%**

**The Dorset Local Enterprise Partnership balances are co-mingled with Dorset Council's.*

6.2 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.

6.3 £83m of the Council's investments are held in externally managed strategic pooled investment vehicles (bond, equity, multi-asset and property funds) where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability.

6.4 These funds have no defined maturity date, but are available for withdrawal after a notice period, and their performance and continued suitability in meeting the Council's investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the expectation that over a three to five-year period total returns should exceed cash interest rates.

6.5 There is a small chance that the Bank of England could reduce 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.

6.6 Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to continue to diversify into more secure and/or higher yielding asset classes during 2020/21.

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

6.8 The Council may invest its surplus funds with any of the counterparty types in table 5 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 5: Approved investment counterparties and limits

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£15m 5 years	£20m 20 years	£20m 50 years	£10m 20 years	£10m 20 years
AA+	£15m 5 years	£20m 10 years	£20m 25 years	£10m 10 years	£10m 10 years
AA	£15m 4 years	£20m 5 years	£20m 15 years	£10m 5 years	£10m 10 years
AA-	£15m 3 years	£20m 4 years	£20m 10 years	£10m 4 years	£10m 10 years
A+	£15m 2 years	£20m 3 years	£15m 5 years	£10m 3 years	£10m 5 years
A	£15m 12 months	£20m 2 years	£15m 5 years	£10m 2 years	£10m 5 years
A-	£15m 6 months	£20m 13 months	£15m 5 years	£10m 13 months	£10m 5 years
None	£5m 6 months	n/a	£20m 25 years	£1m 5 years	£10m 5 years
Pooled funds (including MMFs) and Real Estate Investment Trusts (REITs)			£20m per fund or trust		

This table must be read in conjunction with the notes below:

Credit rating: Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. 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.

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.

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

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

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £[XXX,000] per company as part of a diversified pool in order to spread the risk widely.

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

Pooled funds: Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the

advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

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

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

6.9 The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £1m 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.

6.10 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.

6.11 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.

6.12 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.

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

6.14 The maximum that will be lent to any one organisation (other than the UK Government) will be £20 million. 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 6: Investment limits

	Cash Limit
Any single organisation, except the UK Central Government	£20m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£20m per group
Any group of pooled funds under the same management	£50m per manager
Negotiable instruments held in a broker's nominee account	£50m per broker
Foreign countries	£20m per country
Registered providers and registered social landlords	£50m in total
Unsecured investments with building societies	£20m in total
Loans to unrated corporates	£20m in total
Money Market Funds (MMFs)	£100m in total
Real Estate Investment Trusts (REITs)	£50m in total

6.15 The Council monitors its cash flow forecasting on a daily basis 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.

6.16 The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return. See Annex 2 for further details.

7. Treasury Management Indicators

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

7.2 Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. . Arlingclose calculate the credit score by applying a score to each investment (AAA = 1, AA+ = 2 etc.) and taking the average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

7.3 Arlingclose also calculate the proportion of investments exposed to 'bail-in' risk. (A bail-in provides relief to a financial institution on the brink of failure by requiring the cancellation of debts owed to creditors and depositors. In comparison, a bailout

involves the rescue of a financial institution by external parties, typically governments, using taxpayers' money for funding.)

Table 7: Security

	2020/21 Target
Portfolio average credit rating or score	6.0

7.4 Liquidity: 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. In addition, the Council aims to hold a minimum of £10m readily available in same day access bank accounts and Money Market Funds.

Table 8: Liquidity

	2020/21 Target
Total cash available within 3 months	30%

7.5 Interest Rate Exposure: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Table 9: Interest Rate Exposure

	2020/21 Target £000s
Upper limit on one-year revenue impact of a 1% rise in interest rates	500
Upper limit on one-year revenue impact of a 1% fall in interest rates	500

7.6 The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

7.7 Sums invested for longer than a year: 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 were:

Table 10: Investments beyond year end

	2020/21 £m	2021/22 £m	2022/23 £m
Limit on principal invested beyond year end	20	20	20

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

Table 11: Maturity Structure of Borrowing

	Upper Limit	Lower Limit
Under 12 months	25%	0%
12 Months to 2 Years	25%	0%
2 Years to 5 Years	25%	0%
5 Years to 10 Years	35%	0%
10 Years to 15 Years	35%	0%
15 Years to 20 Years	35%	0%
20 Years to 25 Years	45%	0%
25 Years to 30 Years	45%	0%
30 Years to 35 Years	45%	0%
35 Years to 40 Years	45%	0%
40 Years to 45 Years	45%	0%
45 Years to 50 Years	45%	0%
50 Years and above	75%	0%

7.9 Time periods start on the first day of each financial year, so borrowing maturing "under 12 months" is all borrowing that may mature before the end of this financial year. The maturity date used is the earliest date on which the lender can demand repayment or the borrower has the option to repay without penalty. The next option dates on LOBOs have therefore been treated as the potential repayment date.

8. Financial Derivatives:

8.1 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).

8.2 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.

8.3 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.

8.4 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.

9. Markets in Financial Instruments Directive (MiFID)

9.1 The Council 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 Section 151 Officer believes this to be the most appropriate status.

10. Member and Officer Training

10.1 The high level of risk inherent in treasury management means officers need to be adequately experienced and qualified. Officers attend national treasury management events and training courses, and have regular strategy and review meetings with advisers, as well as regular telephone contact.

10.2 On 23 January 2020 a training session for all Dorset Council's elected members will be provided by officers and advisers to explain the responsibilities that members have in relation to treasury management. Further training will also be provided from time to time as necessary.

11. Procurement of Banking Services

11.1 The predecessor councils all had different providers of banking services – Dorset County Council banked with NatWest, Purbeck District Council with Lloyds, and East Dorset District Council, North Dorset District Council, West Dorset District Council and Weymouth and Portland Borough Council with HSBC.

11.2 Now that the predecessor councils have come together as one organisation, having multiple bankers is not the most efficient and effective way to operate. Following a procurement exercise, NatWest Bank has been appointed as the single provider of banking services for Dorset Council.

12. Other Options Considered

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

Alternative	**Impact on income and expenditure**	**Impact on risk management**
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

Annex 1: Economic and Interest Rate Forecast (Arlingclose November 2019)

Economic background: The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Council's treasury management strategy for 2020/21.

UK Consumer Price Inflation (CPI) for September registered 1.7% year on year, unchanged from the previous month. Core inflation, which excludes the more volatile components, rose to 1.7% from 1.5% in August. The most recent labour market data for the three months to August 2019 showed the unemployment rate ticked back up to 3.9% while the employment rate was 75.9%, just below recent record-breaking highs. The headline 3-month average annual growth rate for pay was 3.8% in August as wages continue to rise steadily. In real terms, after adjusting for inflation, pay growth increased 1.9%.

GDP growth rose by 0.3% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.0% from 1.2%. Services and construction added positively to growth, by 0.6% and 0.4% respectively, while production was flat and agriculture recorded a fall of 0.2%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

The Bank of England maintained Bank Rate to 0.75% in November following a 7-2 vote by the Monetary Policy Committee (MPC). Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the MPC may now be less convinced of the need to increase rates even if there is a Brexit deal.

Growth in Europe remains soft, driven by a weakening German economy which saw GDP fall -0.1% in Q2 and is expected to slip into a technical recession in Q3. Euro zone inflation was 0.8% year on year in September, well below the European Central Bank's target of 'below, but close to 2%' and leading to the central bank holding its main interest rate at 0% while cutting the deposit facility rate to -0.5%. In addition to maintaining interest rates at ultra-low levels, the ECB announced it would recommence its quantitative easing programme from November.

In the US, the Federal Reserve began easing monetary policy again in 2019 as a pre-emptive strike against slowing global and US economic growth on the back on of the ongoing trade war with China. At its last meeting the Fed cut rates to the range of 1.50-1.75% and financial markets expect further loosening of monetary policy in 2020. US GDP growth slowed to 1.9% annualised in Q3 from 2.0% in Q2.

Credit outlook: Credit conditions for larger UK banks have remained relatively benign over the past year. The UK's departure from the European Union was delayed three times in 2019 and while there remains some concern over a global economic slowdown, this has yet to manifest in any credit issues for banks. Meanwhile, the post financial crisis banking reform is now largely complete, with the new ringfenced banks embedded in the market.

Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers.

Looking forward, the potential for a "no-deal" Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

Interest rate forecast: The Council's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the upcoming general election, the need for greater clarity on Brexit and the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its November Monetary Policy Report and its Bank Rate decision (7-2 vote to hold rates) that the MPC now believe this is less likely even in the event of a deal.

Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

Underlying assumptions:

- The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased.

- Some positivity on the trade negotiations between China and the US has prompted worst case economic scenarios to be pared back. However, information is limited, and upbeat expectations have been wrong before.

- Brexit has been delayed until 31 January 2020. While the General Election has maintained economic and political uncertainty, the opinion polls suggest the Conservative position in parliament may be strengthened, which reduces the chance of Brexit being further frustrated. A key concern is the limited transitionary period following a January 2020 exit date, which will maintain and create additional uncertainty over the next few years.

- UK economic growth has stalled despite Q3 2019 GDP of 0.3%. Monthly figures indicate growth waned as the quarter progressed and survey data suggest falling household and

business confidence. Both main political parties have promised substantial fiscal easing, which should help support growth.

- While the potential for divergent paths for UK monetary policy remain in the event of the General Election result, the weaker external environment severely limits potential upside movement in Bank Rate, while the slowing UK economy will place pressure on the MPC to loosen monetary policy. Indeed, two MPC members voted for an immediate cut in November 2019.

- Inflation is running below target at 1.7%. While the tight labour market risks medium-term domestically-driven inflationary pressure, slower global growth should reduce the prospect of externally driven pressure, although political turmoil could push up oil prices.

- Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- Although we have maintained our Bank Rate forecast at 0.75% for the foreseeable future, there are substantial risks to this forecast, dependant on General Election outcomes and the evolution of the global economy.

- Arlingclose judges that the risks are weighted to the downside.

- Gilt yields have risen but remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.

- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.21**
Arlingclose Central Case	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
3-month money market rate														
Upside risk	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30	**0.25**
Arlingclose Central Case	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**	**0.75**
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
1yr money market rate														
Upside risk	0.10	0.20	0.20	0.20	0.20	0.20	0.20	0.25	0.30	0.30	0.30	0.30	0.30	**0.23**
Arlingclose Central Case	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**
Downside risk	-0.30	-0.50	-0.55	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	**-0.60**
5yr gilt yield														
Upside risk	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.45	0.45	0.45	**0.37**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.55**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.60**	**0.57**
Downside risk	-0.35	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	**-0.56**
10yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**0.75**	**0.75**	**0.80**	**0.80**	**0.85**	**0.85**	**0.90**	**0.90**	**0.95**	**0.95**	**1.00**	**1.00**	**1.00**	**0.88**
Downside risk	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.45**
20yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**1.20**	**1.20**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.30**	**1.35**	**1.35**	**1.35**	**1.40**	**1.40**	**1.30**
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	**-0.45**
50yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	**0.37**
Arlingclose Central Case	**1.20**	**1.20**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.30**	**1.35**	**1.35**	**1.35**	**1.40**	**1.40**	**1.30**
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	**-0.45**

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%
PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Annex 2: Non Treasury Investments

The Council invests its money for three broad purposes:

- 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**),
- to support local public services by lending to or buying shares in other organisations (**service investments**), and
- to earn investment income (known as **commercial investments** where this is the main purpose).

This statement meets the requirements of statutory guidance issued by the government in January 2018, and focuses on the second and third of these categories.

Service Investments: Loans

Contribution: The Council may lend money to its subsidiaries, its suppliers, local businesses, local charities, and others to support local public services and stimulate local economic growth.

Security: The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's statement of accounts must be shown net of this loss allowance. However, the Council must make every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

Service Investments: Shares

Contribution: The Council may invest in the shares of its subsidiaries, its suppliers, and local businesses to support local public services and stimulate local economic growth.

Security: One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. In order to limit this risk, upper limits on the sum invested in each category of shares must be set.

Liquidity: Procedures for determining the maximum periods for which funds may prudently be committed must be set.

Commercial Investments: Property

MHCLG defines property to be an investment if it is held primarily or partially to generate a profit.

Contribution: The Council may invest in local, regional, UK and global commercial and residential property with the intention of making a profit that will be spent on local public services

Security: In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs. Where the accounting valuation is below purchase cost, the fair value of the Council's investment property portfolio is no longer sufficient to provide security against loss, and the Council must therefore take mitigating actions to protect the capital invested.

Liquidity: Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. The Council must ensure that invested funds can be accessed when they are needed, for example to repay capital borrowed.

Loan Commitments and Financial Guarantees

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

Risk assessment

The Council must assess the risk of loss before entering into and whilst holding investments making clear in particular :

1. how you have assessed the market that you are/will be competing in, the nature and level of competition, how you think that the market/customer needs will evolve over time, barriers to entry and exit and any ongoing investment requirements;

2. whether and, if so how, you use external advisors;

3. how you monitor and maintain the quality of advice provided by external advisors;

4. to what extent, if at all, any risk assessment is based on credit ratings;

5. where credit ratings are used, how frequently they are monitored and the procedures for taking action if credit ratings change; and

6. what other sources of information are used to assess and monitor risk].

Borrowing in Advance of Need

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.

Investment Indicators

The Council must set quantitative indicators to allow elected members and the public to assess the Council's risk exposure as a result of its investment decisions covering (1) total exposure to potential investment losses, (2) how investments are funded and (3) rate of return received.

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