# Treasury Management and Investment Strategy 2015/16 & Prudential Indicators

## Report by Gary Fairley, Head of Finance and Integrated Service Support

## 1 Purpose of Report

The purpose of the report is to seek the agreement of Council to the Treasury Management and Annual Investment Strategies for 2015/16 and the Prudential and Treasury indicators contained therein.

## 2 Background

### 2.1 Treasury Management & Investment Strategy 2015/16

<u>Treasury Management Code of Practice</u>

The revised Treasury Management Code of Practice, updated by CIPFA in 2011, requires the Council to receive and approve, in advance of each financial year a Treasury Management and Investment Strategy. The strategy encompasses the Council's capital plans and prudential indicators, indicates how the borrowings and investments for the Council are to be organised for the forthcoming year in light of these plans/indicators, and sets parameters on how investments are to be managed for the forthcoming financial year. Investment in each type of instrument must be approved by Council as "permitted" otherwise it will be deemed to be ultra vires.

A detailed document covering the Treasury Management and Investment Strategy for financial year 2015/16 has been included as Appendix 3 to this report. The key points from this strategy are:-

<u>Capital Financing Requirement (CFR)</u>

The Council's capital plans contain projections of capital expenditure and income over the forthcoming financial years. Any expenditure not financed directly by income, requires funding through borrowing.

The Council has an underlying need to borrow over the period 2015/16-2017/18 as follows:-

| | 2013/14 Actual £000 | 2014/15 Estimate £000 | 2015/16 Estimate £000 | 2016/17 Estimate £000 | 2017/18 Estimate £000 |
|---|---|---|---|---|---|
| **Capital Expenditure** | | | | | |
| *General Services* | 17,342 | 15,798 | 36,152 | 18,688 | 5,475 |
| *HRA* | 16,104 | 15,971 | 39,587 | 12,793 | 12,874 |
| **Total** | **33,446** | **31,769** | **75,739** | **31,481** | **18,349** |
| | | | | | |
| **Financed by:** | | | | | |
| *Capital receipts* | 1,569 | 1,955 | 1,955 | 1,955 | 1,955 |
| *Capital grants* | 7,318 | 9,484 | 9,537 | 9,232 | 9,227 |
| *Reserves* | 0 | 0 | 6,000 | 0 | 0 |
| *Developer/Other Contributions* | 2,326 | 4,197 | 10,943 | 118 | 121 |
| **Available Financing** | **11,213** | **15,636** | **28,435** | **11,305** | **11,303** |
| | | | | | |
| **Capital Expenditure less available financing** | **22,233** | **16,133** | **47,304** | **20,176** | **7,046** |
| Principal debt repayments | -6,767 | -7,062 | -7,338 | -8,106 | -8,454 |
| **Underlying need to borrow** | **15,466** | **9,071** | **39,966** | **12,070** | **-1,408** |
| **Expected Change in Gross Debt** | **-4,027** | **27,216** | **36,393** | **11,107** | **-2,224** |

The difference between the underlying need to borrow and the expected change in gross debt in the table above is due to:-

- In 2013/14, the utilisation of the Council's internal cash balances (internal borrowing) to offset external borrowing, due to the continued low investment return environment;
- In 2014/15:-
  - Borrowing of £10m taken in advance of need in December 2014 (i.e. to finance capital expenditure in early 2015/16), to lock in to historically low PWLB rates;
  - A move towards cashbacking the Council's Balance Sheet reserves, thereby reducing the internally borrowed position and increasing the overall level of debt;
  - An decrease in cash resources through the Council's reserves position (specifically the Council's HRA balances), supplementing the need to externally borrow;
- In 2015/16, 2016/17 and 2017/18, the projected increases in the Council's (cash) reserves position reduce the borrowing required to finance the underlying need to borrow.

<u>Borrowing Strategy</u>

The Council is expected to have an under-borrowed (internally-borrowed) position of c. £9.0 million by the end of financial year 2014/15. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as some of the cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are generally low and counterparty risk is relatively high.

It is expected that throughout the majority of 2015/16, temporary borrowing from the money markets or other local authorities will remain at historically low levels of below bank base rate (i.e. sub-0.50%), whilst new long term PWLB borrowing sits at somewhere between 2.7%-4.5%. If rates remain at these levels, utilisation of temporary borrowing within the Council's overall loan portfolio would continue to provide the most cost-effective solution to the Council. However, this will be viewed against the backdrop of potential long term costs if the opportunity is missed to take PWLB loans at historically low medium-long term rates, particularly given the projected gradual rise in PWLB rates.

The Council has a significant borrowing requirement over the short-medium term, with a particular cluster of loans maturing in the period 2.5 years to 6 years from now, all of which will require to be refinanced. The opportunity has arisen to consider forward dealing these loans. This would involve the Council entering into a legal commitment over the course of the next few months, to draw down these loans at specific intervals 2.5 years to 6 years from now, broadly matching the maturity profile of existing loans within this period. This would allow the Council to draw down these loans at interest rates that are priced against current historically low gilt levels, and also significantly less than current market forward projections, and eliminate any cost of carry. Officers will ensure that loans are drawn to match the existing maturity profile as closely as possible, that proposed interest rates continue to sit below forward interest rate projections, and that the overall borrowing remains within the Authorised Limit of £334.1m proposed below.

Any borrowing undertaken in advance of need would be supported by a business case which will appraise the anticipated savings in borrowing costs (from expected increases in rates later in the year / in forthcoming years) against the carrying cost associated with borrowing in advance of need.

Investment Strategy/Instruments

The Scottish Government Investment Regulations make use of many different types of treasury investment instruments available to the Council, and the recommended list of instruments for approval by Council is included in the detailed strategy and reported in Appendix 1.

In a continuously evolving investment climate, this list has been expanded from the Council's previous Investment Strategy to provide flexibility to respond quickly to any changes in the economic climate. Any new investment product will be subject to thorough appraisal and consultation with the Council's Treasury Management advisers Capita prior to the placement of any such investment.

The updated list of Permitted Investments also includes the subscription of subordinated debt to the Newbattle Centre SPV and the utilisation of Certificates of Deposit, both approved by Council on 23 September 2014.

The Council has previously set limits on the total amount of investments it can make with its approved list of counterparties, and it is proposed to retain these at their current levels.

Any borrowing in advance of need would temporarily increase the Council's available cash balances, and consideration will be given to the most advantageous counterparty and term to invest these surplus monies with, while ensuring the Council's priorities of security and liquidity of these funds is upheld.

**2.2 Prudential Indicators**

<u>Prudential Code for Capital Finance in Local Authorities</u>

The Prudential Code for Capital Finance in Local Authorities requires that Councils can demonstrate that their Capital Plans are affordable, prudent and sustainable, taking into account the financial provisions made in current and future Revenue Budgets; and that Treasury Management decisions are taken in accordance with good practice.

The Prudential Indicators that Councils need to consider relate to both actual, historic outcomes, and future estimated outcomes (covering the same period as the Council's Capital Plans), as follows:-

- Original indicators and actual outcomes for 2013/14;
- Revised estimates of the 2014/15 indicators; and
- Estimates of indicators for 2015/16 to 2017/18.

The Prudential Indicators required by the Code are listed individually in Appendix 2.

**3. Report Implications**

**3.1. Resources**

There are no direct resource implications arising from this report.

**3.2. Risk**

The strategies outlined in this report are designed to improve the overall risk management of Treasury activity. Providing the limits outlined in the strategies are observed they will enhance the controls already in place in the Treasury Management Practices within which the treasury function operates.

The Prudential Indicators contained in Appendix 2 improve the overall risk management of Capital Investment and Treasury Management.

**3.3. Single Midlothian Plan and Business Transformation**

Themes addressed in this report:

☐ Community safety
☐ Adult health, care and housing
☐ Getting it right for every Midlothian child
☐ Improving opportunities in Midlothian

☐ Sustainable growth
☐ Business transformation and Best Value
☒ None of the above

**3.4 Impact on Performance and Outcomes**

The strategies to be adopted are an integral part of the corporate aim to achieve Best Value as they seek to minimise the cost of borrowing by exercising prudent debt management and investment. This in turn helps to ensure that the Council's capital expenditure is sustainable in revenue terms.

**3.5 Adopting a Preventative Approach**

The proposals in this report do not directly impact on the adoption of a preventative approach.

**3.6 Involving Communities and Other Stakeholders**

Although no external consultation has taken place, cognisance has been taken of professional advice obtained from Capita Asset Services, the Council's appointed Treasury Consultants.

**3.7 Ensuring Equalities**

There are no equality issues arising from this report.

**3.8 Supporting Sustainable Development**

There are no sustainability issues arising from this report.

**3.9 IT Issues**

There are no IT issues arising from this report.

**4 Summary**

The Treasury Management and Investment Strategies outlined in this document, and in the detailed document attached as Appendix 3, have been formulated to comply with the revised Codes of Practice and relevant Regulations and provide the framework for achieving best value in the management of the Council's borrowing and investment portfolios.

**5 Recommendations**

It is recommended that the Council

a) Approve the Treasury Management and Investment Strategy for the 2015/16 financial year, as summarised in Section 2.1 of this report and as detailed in the in-depth main report that is attached as Appendix 3;
b) Approve the list of Permitted Investments outlined in Appendix 1;

c) Adopt the Prudential Indicators contained in Appendix 2 of this report;

d) Grant permission for total borrowing to be taken up to the Authorised Limit for Borrowing of £334.1m (as shown in item 4.2 of Appendix 2) if market conditions indicate that this is prudent.

Date:- 20 January 2015

**Report Contact:-**
**Name** Gary Thomson
**Tel No** 0131 271 3230
**E mail** gary.thomson@midlothian.gov.uk

**Background Papers:-**
Appendix 1:- Permitted Investments
Appendix 2:- Prudential Indicators
Appendix 3:- Treasury Management & Annual Investment Strategy Statement – 2014/15 Detailed