Treasury Management and Investment Strategy 2016/17 & 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 2016/17 and the Prudential and Treasury indicators contained therein.

2 Treasury Management & Investment Strategy 2016/17

2.1 Current Loan and Investment Portfolio

The Council's current loan and investment portfolio, as at 26 February 2016, is shown in tables 1 and 2 below:-

Table 1: Current Loan Portfolio as at 26 February 2016

Loan Type	Principal Outstanding £000's	Weighted Average Rate
PWLB Annuity	768	8.90%
PWLB Maturity	179,224	4.01%
LOBO	20,000	4.51%
Temporary Market Loans	24,741	0.37%
Other Loans	418	0.00%
Total Loans	**225,151**	**3.66%**

Table 2: Current Investment Portfolio as at 26 February 2016

Investment Type	Principal Outstanding £000's	Weighted Average Rate
Bank Call Accounts	1	0.32%
Money Market Funds	38,906	0.48%
Bank Notice Accounts	14,985	1.15%
Total Investments	**53,892**	**0.67%**

2.2 Borrowing Requirement 2015/16 to 2020/21

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 projected borrowing requirement arising from the Council's Capital Plans, and the maturing long-term loans that require to be refinanced, over the period 2016/17 to 2020/21 is shown in table 3 below:-

Table 3: Total Borrowing Requirement over the period 2016/17 to 2020/21

	2016/17 £000's	2017/18 £000's	2018/19 £000's	2019/20 £000's	2020/21 £000's	Total £000's
Capital Expenditure						
General Services	29,614	17,468	12,707	11,451	10,672	**81,912**
HRA	42,813	14,919	7,303	7,085	7,161	**79,281**
Total Capital Expenditure	**72,427**	**32,387**	**20,010**	**18,536**	**17,833**	**161,193**
Total Available Financing	-12,943	-10,698	-11,165	-9,375	-8,344	**-52,525**
Principal Debt Repayments	-7,411	-8,505	-,9034	-9,362	-9,928	**-44,240**
Capital Expenditure less available Financing	**52,074**	**13,184**	**-189**	**-201**	**-439**	**64,427**
Maturing Loans	2,094	10,275	10,456	9,135	9,146	**41,105**
Total Borrowing Requirement	**54,168**	**23,459**	**10,267**	**8,934**	**8,707**	**105,532**

2.3 Borrowing Strategy for 2016/17

Long-term borrowing rates from the Debt Management Office's (DMO) Public Works Loans Board (PWLB) are currently sitting at, or close to, historical lows. As can be noted from Table 3 above, the Council has a significant borrowing requirement across the forthcoming 2 financial years (2016/17 and 2017/18). It is therefore expected that the majority of the borrowing requirement to fund capital expenditure incurred in 2016/17 and 2017/18 shall be sourced from PWLB unless other, more cost effective options arise.

At the same time, it is also expected that throughout the majority of 2016/17, 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 2.40%-3.30%. If rates remain at these levels, the continued utilisation of temporary borrowing within the Council's overall loan portfolio (current level of £23.6 million as at 18 February 2016 as shown in Table 1) would continue to provide a cost-effective solution to the Council. 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.

As illustrated in table 3 above, the Council also has a significant borrowing requirement over the short-medium term, with a particular cluster of loans totalling £37.2 million maturing in the period 1.5 years to 5 years from now, all of which will require to be refinanced. The opportunity has arisen to consider forward dealing some, or all, of these loans. This would involve the Council entering into a legal commitment to draw down these loans at specific intervals, broadly matching the maturity profile of existing loans and/or projected capital expenditure 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 at significantly lesser rates than current market forward projections, and eliminate the majority of the cost of carry.

Officers will ensure that any loans taken are drawn to match the existing maturity and projected capital expenditure profiles 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 £334.261m proposed below. Any other 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.

2.3 Investment Strategy

The investment environment remains challenging, with the continued scrutiny over the creditworthiness of counterparties resulting in an ever tighter counterparty list. At the same time, the low base rate dictates low returns of typically sub 1% for a 12 month fixed term deposit.

The position on potential investment opportunities remains broadly as reported to Council in the Treasury Management Mid-Year Update report on 3 November 2015.

It is proposed that Council officers, in conjunction with Capita Asset Services, continue to review the range of investment options available to the Council within its stated investment policy in order to select only the most creditworthy counterparties to ensure the security of Council funds, and from that list select the range of investment products that offer best value to the Council's investment portfolio.

The updated list of Permitted Investments in Appendix 1 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. In addition, the potential use of Property Funds has been added to allow the Council to explore options to manage longer-term cash balances.

3 Prudential Indicators

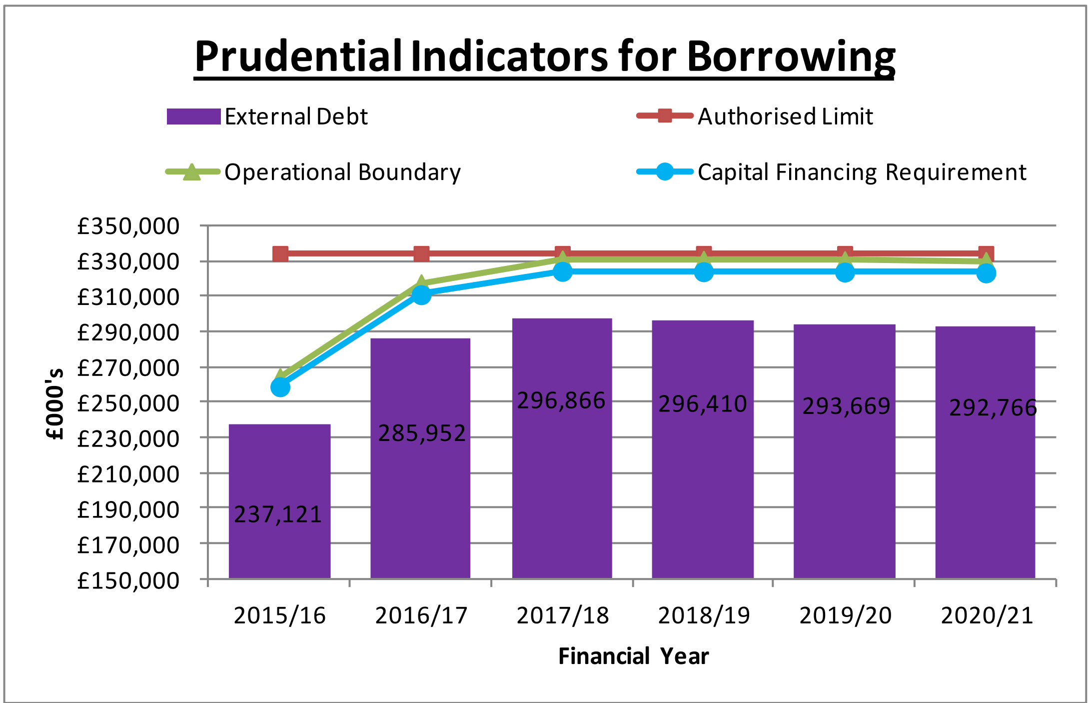
<u>Prudential Code for Capital Finance in Local Authorities</u>

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 2014/15;
- Revised estimates of the 2015/16 indicators; and
- Estimates of indicators for 2016/17 to 2018/19.

The Prudential Indicators required by the Code are listed individually in Appendix 2. The key indicators relating to external borrowing are shown in graphical format below.



The **Capital Financing Requirement (CFR)** denotes the Council's underlying need to borrow for capital purposes. The CFR includes borrowing arising as a result of the Council's Capital Plans, plus the long-term liability arising from the Council's two PPP contracts. The Underlying Borrowing Requirement strips out the latter of these (long-term liability arising from the two PPP contracts) from the CFR.

The **Authorised Limit for Borrowing** represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It is the expected maximum borrowing need with some headroom for unexpected movements.

The Authorised Limit for Borrowing has been calculated by taking the maximum value of the CFR over the next 5 financial years (2016/17 to 2020/21), with the total forecast level of capital receipts and developer contributions added back to this figure (given the inherent uncertainty regarding the timing and value of these receipts/contributions). This is shown in table 4 below.

Table 4: Authorised Limit for Borrowing: Calculation

Authorised Limit	**Amount £000's**
CFR – General Services (31 March 2021)	121,653
CFR – HRA (31 March 2021)	202,464
Unrealised Capital Receipts & Developer Contributions 2015/16	2,084
Forecast level of Capital Receipts & Developer Contributions 2016/17 to 2020/21	8,060
Proposed Authorised Limit	**334,261**

Council is therefore asked to approve an adjustment to the authorised limit for borrowing to £334.261m, if market conditions support this action. This would have the effect of securing lower costs for future years but care would be taken to ensure that the cost of carry from borrowing early is minimized and that the maturity structure of all debt is sufficiently robust to ensure that the CFR at 31 March 2021 remains achievable.

The authorised limit therefore reflects a level of borrowing which, while not desired, could be afforded but is not sustainable

4. Report Implications

4.1 Resources

There are no direct resource implications arising from this report.

4.2 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.

4.3 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

4.4 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.

4.5 Adopting a Preventative Approach

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

4.6 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.

4.7 Ensuring Equalities

There are no equality issues arising from this report.

4.8 Supporting Sustainable Development

There are no sustainability issues arising from this report.

4.9 Digital Issues

There are no IT issues arising from this report.

5 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.

6 Recommendations

It is recommended that the Council

a) Approve the Treasury Management and Investment Strategy for the 2016/17 financial year, as summarised in Section 2 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) Approve an adjustment to the Authorised Limit for Borrowing to £334.261 million (as shown in Section 3) if market conditions indicate that this is prudent.

Date:- 29 February 2016

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Background Papers:-
Appendix 1:- Permitted Investments
Appendix 2:- Prudential Indicators
Appendix 3:- Treasury Management & Annual Investment Strategy Statement – 2016/17 Detailed