Treasury Management and Investment Strategy 2017/18 & 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 2017/18 and the Prudential and Treasury indicators contained therein.

2 Treasury Management & Investment Strategy 2017/18

2.1 Current Loan and Investment Portfolio

The Council's current loan and investment portfolio, as at 27 January 2017, is shown in tables 1 and 2 below:-

Table 1: Current Loan Portfolio as at 27 January 2017

Loan Type	Principal Outstanding £000's	Weighted Average Rate
PWLB Annuity	739	8.90%
PWLB Maturity	197,224	3.77%
LOBO	20,000	4.51%
Temporary Market Loans	36,000	0.25%
Other Loans	357	0.00%
Total Loans	**254,320**	**3.34%**

Table 2: Current Investment Portfolio as at 27 January 2017

Investment Type	Principal Outstanding £000's	Weighted Average Rate
Bank Call Accounts	0	n/a
Money Market Funds	17,941	0.30%
Bank Notice Accounts	64,985	0.85%
Total Investments	**82,926**	**0.73%**

2.2 Borrowing Requirement 2016/17 to 2021/22

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 2021/22 is shown in table 3 below:-

Table 3: Total Borrowing Requirement over the period 2016/17 to 2021/22

	2016/17 £000's	2017/18 £000's	2018/19 £000's	2019/20 £000's	2020/21 £000's	2021/22 £000's	Total £000's
Capital Expenditure							
General Services	34,702	24,263	22,744	19,849	20,576	11,495	**133,629**
HRA	18,393	41,945	27,095	19,434	6,711	5,758	**119,336**
Total Capital Expenditure	**53,095**	**66,208**	**49,839**	**39,283**	**27,287**	**17,253**	**252,965**
Total Available Financing	-23,851	-15,608	-16,513	-17,765	-12,923	-9,960	**-96,620**
Principal Debt Repayments	-7,293	-7,927	-8,883	-9,531	-10,299	-10,863	**-54,796**
Capital Expenditure less available Financing	**21,951**	**42,673**	**24,443**	**11,987**	**4,065**	**-3,570**	**101,549**
Maturing Loans	2,090	10,271	10,452	9,131	9,142	1,394	**42,480**
Total Borrowing Requirement	**24,041**	**52,944**	**34,895**	**21,118**	**13,207**	**-2,176**	**144,029**
Borrowing secured	-20,000	-10,000	-10,000	0	0	0	-40,000
Total Remaining Borrowing Requirement	**4,041**	**42,944**	**24,895**	**21,118**	**13,207**	**-2,176**	**104,029**

2.3 Borrowing Strategy for remainder of 2016/17 and 2017/18

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. Whilst the Council has already secured the majority of its borrowing requirement for financial year 2016/17, as can been noted from Table 3 above the Council has a significant borrowing requirement across the forthcoming 2 financial years (2017/18 and 2018/19).

Part of this borrowing requirement has already been secured through two forward dealt loans. This involved the Council committing to draw down two £10 million loans at fixed interest rates that were priced against historically low borrowing rates, with minimal cost of carry and allowed the Council to hedge against future borrowing rate movements, thereby representing an extremely viable alternative to traditional PWLB borrowing and adding certainty to the Council's loan portfolio. The first of these two loans is to be drawn on 29 June 2017 and the second on 15 November 2018, with these dates matched to two £10 million PWLB loans maturing on the same dates.

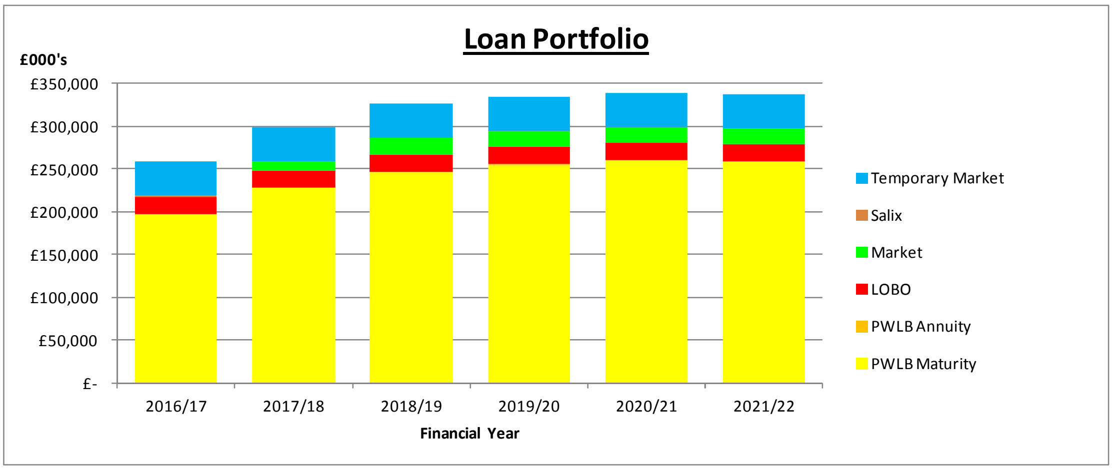
It is expected that the majority of the remaining borrowing requirement to fund capital expenditure incurred in 2017/18 and 2018/19 shall be sourced from PWLB. However, the opportunity continues to exist to consider further loans on a 'forward dealing' basis, and officers will continue to explore the viability of these loans throughout the remainder of 2016/17 and into 2017/18.

In addition to the longer-term element of the borrowing portfolio as noted above, the current low Bank of England base rate level of 0.25% and the expectation that base rate will not rise markedly in the short-medium term, means that continued utilisation of an element of temporary borrowing within the Council's overall loan portfolio (current level of £36.0 million as at 27 January 2017 at an average borrowing rate of 0.25% as shown in Table 1) would continue to provide a cost-effective solution to the Council. The quantum of this will continue to be assessed 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.

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 £384.042 million 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.

The Council's projected loan portfolio over the period 2016/17 to 2021/22 is shown in graphical format below.



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 0.25% Bank of England 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 08 November 2016.

£40.000 million of the Council's investments are held in fixed term deposits which mature in late March / early April 2017 and £24.985 million in bank notice accounts (with the notice period equating to broadly 6 months). Council officers, in conjunction with Capita Asset

Services will continue to review the range of investment options available to the Council, within the proposed Permitted Investments included as Appendix 1, 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.

3 Prudential Indicators

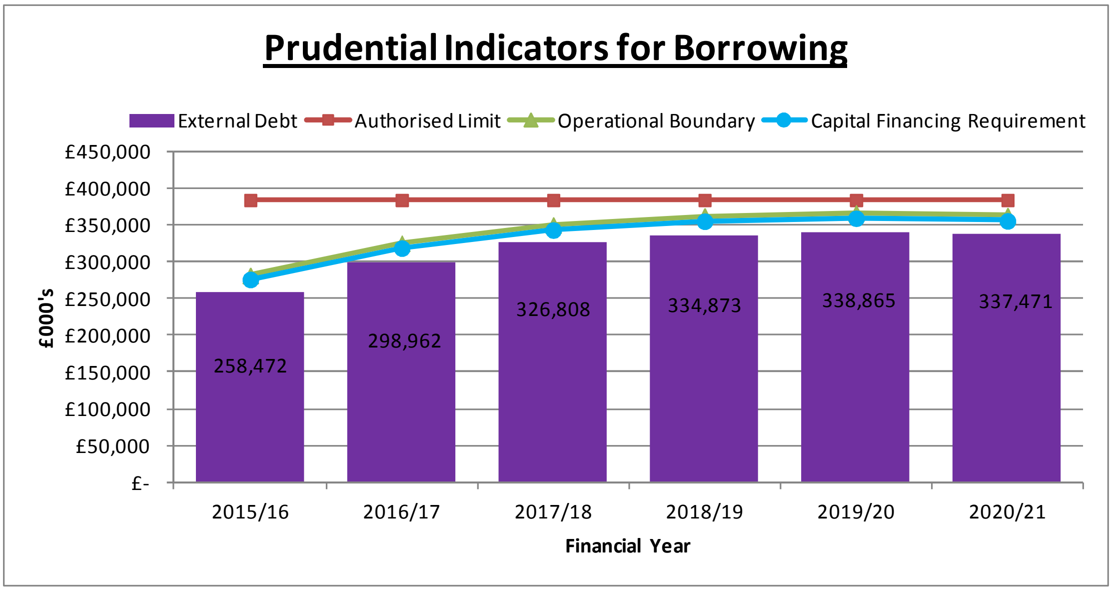
Prudential Code for Capital Finance in Local Authorities

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 2015/16;
- Revised estimates of the 2016/17 indicators; and
- Estimates of indicators for 2017/18 to 2021/22.

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 (2017/18 to 2021/22), 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)	128,063
CFR – HRA (31 March 2021)	231,089
Unrealised Capital Receipts & Developer Contributions 2016/17	10,105
Forecast level of Capital Receipts & Developer Contributions 2017/18 to 2021/22	14,785
Proposed Authorised Limit	**384,042**

Council is therefore asked to approve an adjustment to the authorised limit for borrowing to £384.042million, 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 2022 remains achievable.

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

<u>Statutory repayment of loans fund advances</u>

Under Finance Circular 7/2016, Council is now required to set out its policy for the statutory repayment of loans fund advances prior to the start of each financial year. The repayment of loans fund advances ensures that the Council makes a prudent provision each year to pay off an element of the accumulated loans fund advances made in previous financial years.

A variety of options are provided to Councils so long as a prudent provision is made each year. The Council is recommended to approve the following policy on the repayment of loans fund advances:-

- For loans fund advances made before 1 April 2016, the policy will be to maintain the practice of previous years and apply what is termed "the Statutory Method", with all loans fund advances being repaid by the annuity method.
- For loans fund advances made after 1 April 2016, the policy for the repayment of loans advances is proposed to continue to operate under the "Statutory Method" – i.e. loans fund

advances will be repaid by the annuity method. This annuity rate that is proposed to be applied to the loans fund repayments is based on historic interest rates and is currently 3.20%.

Under current legislation, the Statutory Method i.e. the annuity approach can be applied up to and including 31 March 2021, at which point consideration will need to be given to a number of alternative methods, with the broad aim to ensure that repayment periods are 'reasonably commensurate with the period and pattern of the benefits provided to the community from capital expenditure'. Officers will review the impact of this on loan charges from 31 March 2021 and report back to Council in due course.

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 that has been placed in the Member's Library / uploaded to the Council's Committee Management System, 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 2017/18 financial year, as detailed in Section 2 of this report;
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 £384.042 million (as shown in Section 3) if market conditions indicate that this is prudent;
e) Note that the policy to repay loans fund advances made before 1 April 2016 will be to continue to use the 'Statutory annuity method';
f) Approve the policy for the statutory repayment of loans fund advances made from 1 April 2016 to be the 'Statutory annuity method' and that the current annuity rate applied is 3.20%.

Date:- 31 January 2017

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Background Papers:-

Appendix 1:- Permitted Investments
Appendix 2:- Prudential Indicators
Appendix 3:- Treasury Management & Annual Investment Strategy Statement – 2017/18 Detailed – placed in Member's Lounge / uploaded to Committee Management System