REPORT TO: **MORAY COUNCIL ON 27 FEBRUARY 2019**

SUBJECT: **TREASURY MANAGEMENT STRATEGY STATEMENT AND PRUDENTIAL INDICATORS**

BY: **CORPORATE DIRECTOR (CORPORATE SERVICES)**

1. REASON FOR REPORT

1.1 The purpose of this report is to ask Members to approve the Treasury Management Strategy and the Investment Strategy for 2019/20 and to approve the indicators which will be used to measure the Council's performance in capital investment decisions.

1.2 This report is submitted to Council in terms of Section III B (3) of the Council's Administrative Scheme relating to the implementation and monitoring of the Treasury Policy Statement dealing with the management of all money and capital market transactions in connection with cash funding resources of the Council.

2. RECOMMENDATION

2.1 It is recommended that Council approves:

(i) the Treasury Management Strategy Statement for 2019/20;

(ii) the Investment Strategy for 2019/20 in APPENDIX 1; and

(iii) the Prudential Indicators and Limits for 2019/20 in APPENDIX 3.

2.2 It is recommended that Council notes the indicative Prudential Indicators and limits for 2020/21 and 2021/22.

3. BACKGROUND

3.1 The Local Government (Scotland) Act 2003 (the Act) and supporting regulations requires the Council to adhere to the CIPFA Treasury Management Code of Practice.

3.2 The Act and subsequent Local Government Investments (Scotland) Regulations 2010 require the Council to set out its Treasury Strategy for borrowing and to prepare an annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

3.3 The Act also requires the Council to adhere to the CIPFA Prudential Code and to set prudential and treasury indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. The prudential system, underpinned by legislation and regulation, provides a self-regulatory framework.

4. TREASURY MANAGEMENT STRATEGY 2019/20

4.1 Current Treasury Position

4.1.1 The Council's borrowing and investments at 7 February 2019 are set out in the table below:

		Actual	Average Interest Rate
		£000	%
Fixed Rate Debt	PWLB (1)	**149,274**	**4.77**
	LOBO (2)	**10,100**	**3.95**
	Market	**23,300**	**5.00**
Variable Rate Debt	PWLB	**-**	**-**
	LOBO	**-**	**-**
Temporary Borrowing – Local Authorities	(3)	**23,500**	**0.91**
Total External Borrowing		**206,174**	**4.31**
Other Liabilities	(4)	**57,746**	**n/a**
Total Gross External Debt		**263,920**	**n/a**
Investments **Short Term Investments**		**18,425**	**0.74**
Net Debt		**245,495**	**n/a**

(1) PWLB - Public Works Loan Board.

(2) LOBO - Lender's Option Borrower's Option where the lender has the option to propose an increase to interest rates at set dates and the borrower (the Council) has the option to either accept the new rate or to repay the loan.

(3) Temporary borrowing is borrowing for periods of less than twelve months.

(4) Other liabilities are those relating to the financing of capital expenditure, for example finance leases and Public Private Partnership (PPP) arrangements.

4.2 Interest Rates Forecast

4.2.1 The Council has appointed Arlingclose as treasury management advisers and receives advice on investment, debt and capital finance issues. The Council recognises that responsibility for treasury management decisions rests with the Council and cannot be delegated to the adviser.

4.2.2 Arlingclose's central case is for UK Bank Rate to remain at 0.75% during the first 3 quarters of 2019/20, with an expectation of The Monetary Policy Committee raising rates in the last quarter to 1.00% after an extended period of uncertainty or a delay to Brexit. Forecasts for higher short term interest rates have been pushed back due to the short period of time available for a Brexit withdrawal deal to be agreed and the possibility of an extended period of uncertainty over the possible outcome.

4.2.3 The Arlingclose central case is for gilt yields to see some upward movement from current levels based on a Brexit transitionary period. However, projected deterioration in the economic outlook and continuing volatility arising from both economic and political events may offer an upside on borrowing opportunities.

4.2.4 A more detailed economic and interest rate forecast provided by Arlingclose is attached at **APPENDIX 4.**

4.3 Borrowing Strategy 2019/20

4.3.1 The Council's main objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

4.3.2 Given the significant cuts to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

4.3.3 By adopting the above approach, the Council is able to reduce net borrowing costs and reduce overall treasury risk. The benefits of either using internal resources or borrowing short-term 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. The Council's advisers will assist with this breakeven analysis which may determine whether the Council borrows additional sums at long-term fixed rates in 2019/20 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

4.3.4 The Council will continue to borrow short term loans, normally one to six months, to cover cash flow shortages.

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

- PWLB and any successor body
- UK Local Authorities
- Any Bank or Building Society authorised to operate in the UK.
- UK public and private sector pension funds
- Capital market bond investors
- Special purpose companies created to enable joint local authority bond issues

4.3.6 At 1 April 2018 the Council held £10.1 million in one LOBO loan. The Council will take the opportunity to repay the remaining LOBO loan at no cost if the opportunity arises.

4.3.7 The Council may, where required, borrow in advance of need, where this is expected to provide the best long term value for money. As sums borrowed will be invested until expenditure is incurred, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

4.4 Debt Rescheduling

4.4.1 The PWLB allows Councils to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. The current low interest rate environment and current rules regarding the premature repayment of PWLB loans has adversely affected the scope to undertake meaningful debt restructuring in recent years and there is no indication that this will change during 2019/20.

4.4.2 Other lenders, other than the PWLB, may also be prepared to negotiate premature redemption rates. This will be closely monitored with regard to the LOBO loan (£10.1m) and Market Loan (£23.3m). The Council will take the option to repay these loans at no cost if such an opportunity arises.

4.5 Financial Derivatives

4.5.1 In the absence of any legal power to do so, the Council will not use standalone financial derivatives such as swaps, forwards, futures and options. Derivatives embedded into loans and investments may be used and the risks they present will be managed in accordance with the overall treasury risk management strategy.

5. INVESTMENT STRATEGY 2019/20

5.1 The Local Government Investment (Scotland) Regulations 2010 require the Council to approve an annual Investment Strategy. This has been included as **APPENDIX 1** to this report.

5.2 The primary principle governing the Council's investment criteria is the security of capital and liquidity of its investments. The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

5.3 The Council may invest its surplus funds with any of the Approved Counterparties listed in **APPENDIX 2**, subject to the cash and time limits shown.

6. PRUDENTIAL AND TREASURY INDICATORS

6.1 The key objectives of the Prudential Code are to ensure that capital investment plans of the Council are affordable, prudent and sustainable. To demonstrate these objectives the Code sets ten prudential and treasury indicators designed to support and record capital investment and treasury decision making. These are detailed in **APPENDIX 3**.

6.2 The main principles behind the prudential framework are the affordability, sustainability and prudence of borrowing decisions. It is a statutory requirement under Section 93 of the Local Government Finance Act 1992 for the Council to produce a balanced budget. In particular, a local authority must calculate its budget requirement for each financial year to include the revenue costs incurred from capital financing decisions.

6.3 **Affordability**
The fundamental objective of affordability is to ensure that capital plans remain within sustainable limits. The impact on financing and running costs is the driver of affordability rather than the level of capital budgets available. At the Council meeting on 25 May 2016, it was formally recognised that the Council's asset base is not financially sustainable and a "Make Do and Mend" policy was adopted as an interim guide for the Capital Plan. The Council on 12 December approved a Property Asset Management Appraisal under which the Council's property asset base will be reviewed. Setting affordable limits for borrowing within a prudential framework is a specific requirement and helps ensure that the further objectives of sustainability and prudence are addressed.

6.4 **Sustainability**

The sustainability of the council's finances underpins the overall financial framework and is supported by the prudential code. Sustainability of finances relates to the ability of the council to sustain its current spending, tax and other policies in the long run without threatening council solvency or defaulting on its liabilities or promised expenditure.

6.5 **Prudence**
The prudent level of borrowing is linked to ensuring that debt will only be for a capital purpose. It is also prudent that treasury management activities are carried out in accordance with good professional practice. Within the CIPFA Prudential Code, local authorities are required to adopt the CIPFA Treasury Management Code of Practice.

6.6 The Local Government in Scotland Act 2003 also requires the Council to determine and continuously review how much it can afford to allocate to capital expenditure. This is known as the "Affordable Capital Expenditure Limit".

6.7 The Indicators and Limits for 2019/20 are based on the General Services Capital Plan and the Housing Revenue Account Investment Plan 2019/20 presented as separate papers for consideration at this meeting.

6.8 Prudential Indicators are for 2019/20 only as the capital plan for General Services is proposed for one year only, namely 2019/20. However, indicative figures for 2020/21 and 2021/22 are included.

6.9 Actual outturn figures for 2017/18 have previously been reported to Policy and Resources Committee on 2 October 2018 (paragraph 6 of the minute refers) and these figures have also been included in the report for comparison purposes.

6.10 This report also updates the previously approved indicators for 2018/19 based on the latest estimated outturn for 2018/19.

7. SUMMARY OF IMPLICATIONS

(a) Corporate Plan and 10 Year Plan (Local Outcomes Improvement Plan (LOIP))

None specifically arising from this report.

(b) Policy and Legal

The Local Government in Scotland Act 2003 provides the powers to borrow and invest as well as providing controls and limits on these activities.

The Council has adopted the CIPFA Prudential Code and the CIPFA Treasury Management in the Public Services Code of Practice and Guidance Notes ("the CIPFA Code") which was revised in 2017. The Council also complies with the Local Government Investments (Scotland) Regulations 2010 ("the Regulations").

All Treasury Management activities are carried out in accordance with the CIPFA Code and the Regulations.

(c) Financial implications

All financial considerations are contained within the body of the report and the attached **APPENDICES 1 - .4**

The net cost of Capital Investment and Treasury Management activities has a significant effect on the Council's overall finances.

When considering the level of future capital investment programmes, the council should be aware of the impacts of proposed capital spend on the Revenue Budget.

(d) Risk Implications

The Council is aware of the risks of passive management of the treasury portfolio and, with the support of the Council's treasury advisers, will proactively managed its investments and debt over the year.

Capital expenditure is closely monitored and Budget Managers are aware of their responsibilities to manage budget allocations.

(e) Staffing Implications

None specifically arising from this report.

(f) Property

None specifically arising from this report.

(g) Equalities/Socio Economic Impact

None specifically arising from this report.

(h) Consultations

This report has been produced in consultation with Arlingclose.

8. CONCLUSION

8.1 The adoption of the Treasury Management Strategy Statement will ensure that the Council adopts best practice in its treasury activities.

8.2 The Investment Strategy will ensure that the Council will achieve the optimum return on its investments whilst maintaining a high level of liquidity to allow flexibility and above all ensure that the Council's investments are secure.

8.3 Establishing and subsequent monitoring of Prudential and Treasury Indicators will ensure that the Council has capital investment plans which are affordable, prudent and sustainable.

8.4 Prudential Indicators and Limits are proposed for 2019/20 only, as the proposed Capital Plan is for this year only. Indicative figures for 2020/21 and 2021/22 are identified.

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Background Papers:
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