



REPORT TO: SPECIAL MORAY COUNCIL ON 3 MARCH 2020

SUBJECT: TREASURY MANAGEMENT STRATEGY STATEMENT AND PRUDENTIAL INDICATORS

BY: DEPUTE CHIEF EXECUTIVE (ECONOMY, ENVIRONMENT AND FINANCE)

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 2020/21 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 2020/21;
 - (ii) the Investment Strategy for 2020/21 in APPENDIX 1; and
 - (iii) the Prudential Indicators and Limits for 2020/21 in APPENDIX 3.
- 2.2 It is recommended that Council notes the indicative Prudential Indicators and limits for 2021/22 and 2022/23.

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 2020/21

4.1 Current Treasury Position

- 4.1.1 The Council's borrowing and investments at 11 February 2020 are set out in the table below:

		Actual	Rate
		£000	%
Fixed Rate Debt	PWLB	148,033	4.76
	LOBO	10,100	3.95
	Market	23,300	5.00
Variable Rate Debt	PWLB	-	-
	LOBO	-	-
Temporary Borrowing – Local Authorities		34,500	0.89
Total External Borrowing		215,933	4.13
Other Liabilities		56,204	n/a
Total Gross External Debt		272,137	n/a
Investments			
Short Term Investments		15,328	0.70
Net Debt		256,809	n/a

PWLB is the Public Works Loan Board. LOBO is 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. Temporary borrowing is borrowing for periods of less than twelve months. 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 receive 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 The authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.75% for the foreseeable future. However, substantial risks to this

forecast remain, arising primarily from the Government's policy around Brexit and the transitional period.

The Arlingclose central case is for gilt yields to 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. Gilt yields are expected to remain at relatively low levels for the foreseeable future and the risks are judged to be broadly balanced.

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

4.3 Borrowing Strategy 2020/21

- 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 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 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 2020/21 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
 - UK Municipal Bonds Agency PLC and other special purpose companies created to enable joint local authority bond issues

The UK Municipal Bonds Agency plc was established in 2014 by the Local Government Associations 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 – for whatever reason - the agency is unable to; 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 UK Municipal Bonds Agency will therefore be subject of a separate report to Full Council.

- 4.3.6 At 1 April 2019, the Council held £10.1 million of 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. 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. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this facility and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall saving or reduction in risk.
- 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.
- 4.4.3 The current low interest rate environment and changes in the 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 2020/21.

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 2020/21

- 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 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.

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. The Medium to Long Term Financial Strategy which is presented to this meeting of Council as another item on the agenda recommends reviewing the percentage of revenue budget planned to be spent on servicing debt as an additional method of ensuring affordability

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 2020/21 are based on the General Services Capital Plan presented in a separate report for consideration at this meeting and the Housing Revenue Account Investment Plan 2020/21 which was

approved by Council at its meeting on 12 February 2020 (paragraph x of the Minute refers.) .

- 6.8 Prudential Indicators are for 2020/21 only as the capital plan for General Services is proposed for one year only, namely 2020/21. However, indicative figures for 2021/22 and 2022/23 are included.
- 6.9 Actual outturn figures for 2018/19 have previously been reported to Policy and Resources Committee on 3 September 2019 (paragraph 11 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 2019/20 based on the latest estimated outturn for 2019/20.

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 2020/21 only, as the proposed Capital Plan is for this year only. Indicative figures for 2021/22 and 2022/23 are identified.

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Background Papers:

Ref: