Council: 27th February 2019

Report of: **Borough Treasurer**

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SUBJECT: TREASURY MANAGEMENT FRAMEWORK INCLUDING CAPITAL FINANCING AND CAPITAL STRATEGY

Wards affected: Borough Wide

1.0 PURPOSE OF REPORT

1.1 To set the framework for capital financing and treasury management operations for the next financial year.

2.0 RECOMMENDATIONS

2.1 That the projected position in respect of the Prudential Indicators, as set out in Appendix 1, for 2018-19 be noted.

2.2 That the Prudential Indicators for the next three years be agreed, as set out in Appendix 2.

2.3 That the minimum revenue provision (MRP) policy as set out in Appendix 3, be approved for the next financial year.

2.4 That the Capital Strategy as set out in Appendix 4, be approved for the next financial year.

3.0 BACKGROUND

3.1 The introduction of the 2003 Prudential Code for Capital Finance allowed Councils to determine their own level of borrowing taking account of a set of prudential indicators. The general maxim is that borrowing is to be affordable, prudent and by conclusion sustainable. Subsequent to that legislation, the 2012 Housing Self Financing regulations introduced a debt cap that set a maximum amount for Housing Revenue Account borrowing. In 2018 Government announced that the HRA debt cap has now been removed and this has been confirmed by determination.

3.2 Indicators are to be used as a guide in order to determine an affordable level of borrowing that the Council can undertake in order to support its capital programme. Further, the indicators are to be calculated over a three-year period in order to highlight any trends. Also, indicators have to be calculated for the General Revenue Account (GRA) and the Housing Revenue Account (HRA) in certain instances.

3.3 The Council approved Prudential Indicators for 2018-19 and the subsequent two financial years at Council in February 2018. It is recognised best practice that Treasury Management arrangements and the MRP policy should be considered on a regular basis to ensure they take account of recent developments and new information.

3.4 The CIPFA Treasury Management Code of Practice requires Authorities to have a Treasury Management Strategy and this report sets out the Council's strategy for the next financial year.

3.5 The Treasury and Prudential Code was updated recently and it now requires that the performance indicators reported are expanded upon. This is to assist members and other interested parties to understand the total exposure from borrowing and investment decisions, the issue is addressed in section 5 of the report. It also now requires that a Capital Strategy is produced and this has been attached as Appendix 4.

4.0 FORECAST PRUDENTIAL INDICATOR PERFORMANCE

4.1 Appendix 1, Part A, details the estimate and the projected outturn in relation to the principle of affordability contained within The Prudential Code for the current year.

4.2 The first indicator shows that the forecast financing costs on the GRA are lower than the estimate, this is due to having greater cash sums to invest. The HRA position is nearly on line with that forecast.

4.3 With regard to the HRA, there is a fixed interest charge of £3.056m levied on this account as a result of the borrowing of £88.212m undertaken for HRA self-financing. Consequently the ratio of net financing costs to net revenue stream is higher than for the GRA.

4.4 The second indicator, impact of capital decisions on the Council Tax, is either positive or nil. This is because when investments have been considered or undertaken they have only proceeded when the business case has demonstrated a positive rate of return.

4.5 Appendix 1, Part A, Table 2 details the Prudential Indicator in relation to capital expenditure, which falls under the principle of Prudence. The figures represent the total scheme approvals for the capital programme. The main message is that the schemes are fully financed and that the actual expenditure incurred to date is less than the budgetary sums provided.

4.6 There is also a requirement to report upon the Capital Financing Requirement of the Council. This indicator details the authority's underlying need to borrow for a capital purpose. Due to its nature it can only be reported upon when the fixed asset accounts are closed. Hence, this will be reported to Members in summer 2019.

4.7 Appendix 1, Part B, shows that the Council has not breached any of its borrowing limits during the financial year. The figure for 'Other Long Term Liabilities' represents the agreement the Council has with Serco Paisa in respect of the investment they are undertaking within the Council's leisure centres. This agreement ceases at the end of March 2020

4.8 Overall, the indicators show that even though the Council's financial landscape is challenging it is currently in a healthy financial position and that there are no significant problems that need to be brought to the attention of Members.

5.0 FORECAST 3-YEAR PRUDENTIAL INDICATORS AND PERFORMANCE PI'S

5.1 The three year prudential indicators reported have been expanded to reflect the new regulations in this area, as explained in the background section of this report.

5.2 The first new PI reported is gross debt to net service expenditure for the GRA. The purpose of this PI is to show the amount of gross borrowing in the context of the size and financial strength to the Council as demonstrated by a proxy, this being the net service expenditure. At the current time the GRA has no gross borrowing however the Council has approved the Skelmersdale Town Centre development that is likely to require a level of borrowing to finance the scheme. The amount of borrowing and when it is to be incurred is still unclear. The PI has assumed that an amount will be required in financial year 20-21. There are no other approvals that have been approved by Council but there are future plans for a Development Company and the rebuild of the Leisure Centres. Both of these schemes will be reported to Members and approval levels sought. Once these are known they will then be part of the PI reported. It is worth explaining that this PI is a good broad indicator of risk exposure when undertaking borrowing. The level reported should not be considered in isolation as each scheme that the Council approves will be subject to a detailed business case analysis and discounted cash flow, if appropriate. Hence, each scheme will be reported in detail and scrutinised accordingly.

5.3 The second PI reported is void levels of Commercial Assets. Clearly this PI shows that if we have high occupancy levels that the resultant income streams should be more secure. Avoiding vacancies is important not just from an income generating point but also the ability to have tenants to levy the service charges thereon and to avoid empty business rates liability that the unit may be subject to.

5.4 The commercial income levels PI is based upon actual performance and forecast for the current 2018-19 financial year. The purpose of this PI is to show the trend of the income levels being achieved.

5.5 With regard to the GRA the net financing costs are forecast to decrease as investment returns are projected to increase as a result of forecast Bank of England (BoE) base rate increases.

5.6 The incremental impact on the Council Tax as a result of the capital programme is estimated to be nil as although there may be some borrowing in the future, for example invest to save schemes, these would be progressed only if the business case demonstrated that they had at least a neutral effect on the revenue position. The Government have introduced a policy whereby HRA rental levels have to be reduced by 1% per annum over the next four years, and consequently the HRA capital programme will not have a direct effect on the rental levels that are charged.

5.7 Appendix 2, Table 5, details the Indicators with regard to future capital expenditure and the capital financing requirement. The Council's three year capital programme is discussed elsewhere on the agenda, as such, the figures presented are in line with those previously reported to Members and will be updated to reflect the decisions made at this Council meeting.

5.8 The capital financing requirement measures the Council's underlying need to borrow for a capital purpose. As a key indicator of prudence the Prudential Code states:

'In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current year and next two financial years.'

5.9 The Council should have no difficulty meeting this requirement in 2018-19 nor are any difficulties envisaged for future years. This view takes into account current commitments and existing plans.

5.10 Appendix 2, Part B, details the prudential indicators that are relevant for the purposes of setting an integrated treasury management strategy.

5.11 In respect of external debt, it is recommended that the Council approve the authorised limits, in Appendix 2, for its total external debt gross of investments. These authorised limits are consistent with the authority's current commitments, existing plans and the proposals in the budget reports for capital expenditure and financing. They are based on the estimate of most likely, prudent but not worst case scenario, with in addition sufficient headroom over and above this to allow for operational management, for example unusual cash movements. Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the capital financing requirement and estimates of cash flow requirements for all purposes.

5.12 The Council is also asked to approve the operational boundary for external debt for the same period. The proposed operational boundary for external debt is based on the same estimates as the authorised limit but reflects the most likely, prudent but not worst case scenario without the additional headroom included in the authorised limit. Within the authorised limit and operational boundary, figures for borrowing and other long-term liabilities are separately identified. The Borough Treasurer has authority to effect movement between these figures for borrowing and other long-term liabilities within the total authorised and operational boundary for any individual year. Any such changes will be reported to the Council at its next meeting following the change.

6.0 MRP AND HOUSING DEBT REPAYMENT POLICIES

6.1 The basic idea behind the MRP is that a minimum level of funding should be set aside each year for the repayment of borrowing or other long term liabilities on a prudent basis. There are regulatory requirements that must be met in setting the MRP and the policy should be reviewed on an annual basis. The proposed policy for the next year is set out in Appendix 3. The HRA Debt Repayment policy was also reviewed as part of the Policy Options process, and it was agreed that debt repayments would be suspended during the 4 year period to 2020 while the Government is requiring rent reductions to be made, and the new policy reflects this position in the treatment of the allowable debt element of capital receipts. Presently there are no plans in place to take advantage of the raising of the HRA debt cap. Any plans that are formulated will be subject to Council approval and would undergo a robust financial analysis as part of the approval process.

7.0 TREASURY MANAGEMENT STRATEGY 2019-20

7.1 The Council's cash flow position is actively managed in order to avoid any short-term deficits arising, however in light of a number of large projects due to commence in 2019/20, some borrowing of this nature may be required.

7.2 Members are assured that the Treasury team act in accordance with the principles set out in the CIPFA Treasury Management Code of Practice with the objective of minimising the debt costs and financial risks that face the Council as a result of borrowing.

PROSPECTS FOR INTEREST RATES

7.3 Link Asset Services (formerly Capita) act as a Treasury Adviser to the Council and part of their service is to assist in formulating views on interest rates.

7.4 The table below gives the Link central view on future interest rate movements.

	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020
Base Rate	0.75%	1.00%	1.00%	1.00%	1.00%

Public Works Loan Board (PWLB) interest rate on 25 year borrowing 2.50%

7.5 As can be seen from the above table Link is predicting a rate rise in March 2019 of 0.25% and that the base rate hold steady at 1.00% over the rest of 2019/20. This will have an effect on our Treasury Management performance in 2019/20 and may increase income levels when compared with 2018/19. PWLB rates are expected to rise slowly over the same period.

7.6 It should be noted that there are a number of factors that could have a major impact on the prospects for interest rates in the short to medium term, the most significant of which is the UK's exit from the European Union. The Treasury Management team will therefore closely monitor the interest rate market and adopt a pragmatic approach to any changing circumstances, reporting any decisions to the Council at the next available opportunity.

INVESTMENTS STRATEGY

7.7 The key feature of the Investment Strategy will remain, as it has been in the past, the security of the money that is invested, followed by liquidity and finally, yield.

7.8 It is anticipated that, during 2019/20, the Council should on average have somewhere in the region of £20m available for investment, although the level of investments can vary significantly at different times of the year.

7.9 There are a number of protocols in place to guarantee the safety of our investments. We will continue with these protocols, in that we will only invest with U.K. based counterparties that have the best available credit rating. Currently only four British High Street banks, five Building Societies and local authorities meet the criteria used for investment purposes.

7.10 There will be continued regular interaction with Link to ensure that we are up to date with changes in the markets and the financial situation in general. The Council will look to ensure the security and liquidity of its funds invested and then look to maximise its return on investments. Performance will continue to be monitored against our previously declared benchmark of the 3 month LIBID interest rate.

BORROWING STRATEGY

7.11 The loan for the Housing self-financing payment of £88.212m to central government was arranged via the Public Works Loan Board. Given the special discount applied by the PWLB to its interest rates specifically for this purpose, the loans offered the most preferential rate available to the Council in which to finance the debt.

7.12 The structure of the loan has been set over the longer term, with at the time of borrowing loan periods ranging from 15 to a maximum of 50 years. The structure of the debt is in line with treasury risk management principles and a detailed outline of the debt profile is attached in Appendix 2.

7.13 In recent years an approach has been adopted of reducing the level of cash investments to avoid the need to borrow to support the capital programme. This approach is appropriate given that the interest rate earned on cash investments is significantly lower than the interest rate paid on external borrowing. This approach will continue to be used going forward but as mentioned in Section 5.2 with a number of significant projects due to commence the requirement for long term borrowing is extremely likely.

8.0 SUSTAINABILITY IMPLICATIONS

8.1 The Capital Financing and Treasury Management Framework ensures that robust financial decisions are made. The strategies in place provide for sound financial management decision making with regards to the Council's assets and their sustainability. This report has no significant impacts on crime and disorder.

9.0 RISK ASSESSMENT

9.1 The Council is signed up to the CIPFA Treasury Management Code of Practice and it reviews the Prudential Indicators on a regular basis. It is, therefore, minimising the risks associated with financing decisions.

Background Documents

Treasury Management in the Public Services, Code of Practice and Cross-Sectoral Guidance Notes 2017 Edition.

Equality Impact Assessment

The decision does not have any direct impact on members of the public, employees, elected members and/or stakeholders. Therefore, no Equality impact assessment is required.

Appendices

Appendix 1 – Forecast Indicators
Appendix 2 – Three year prudential indicators
Appendix 3 – Minimum Revenue Provision
Appendix 4 – Capital Strategy