Council:

26th February 2020

Report of:	**Head of Finance, Procurement and Commercial Property**
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SUBJECT: CAPITAL FINANCIAL AND TREASURY MANAGEMENT FRAMEWORK

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 for 2019-20 set out in Appendix 1 be noted.

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

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

2.4 That the Treasury Management Strategy set out in section 7 of the report be approved, including the prepayment of pension contributions.

2.5 That authority to make the Investment Decisions set out in paragraph 7.8 be delegated to the Strategic Assets Purchasing Committee.

3.0 BACKGROUND

3.1 The Council has the ability to borrow to support its capital investment programme, subject to regulations that require any borrowing to be affordable, prudent and

sustainable. These regulations require consideration to be given to a range of prudential indicators in determining what represents an appropriate level of borrowing. The Council approved targets for the prudential indicators for 2019-20 and the subsequent two financial years at its meeting in February 2019. This report considers performance against the targets for 2019-20 and sets out proposed targets for the next 3 years, taking account of new information and planned future developments. It is also recognised best practice that the MRP policy (which governs the repayment of debt and other long term liabilities) should be reviewed on a regular basis, and an updated policy is proposed as a result of the latest review.

3.2 The CIPFA Treasury Management Code of Practice requires Authorities to have a Treasury Management Strategy in place, and this report sets out the proposed strategy for the next financial year. The code also requires that a Capital Strategy should be put in place and that performance indicators are expanded upon to aid understanding of exposure risks and investment decisions.

3.3 It is expected that the next 3 years will see a significant increase in external borrowing for a range of different initiatives including the Skelmersdale Town Centre Redevelopment, investment in affordable housing, and investment in Tawd Valley Developments Limited (there is a separate report on the Council's Development Company elsewhere on the agenda). The Sustainable Organisation Review (SORP) has also already agreed that up to £10m be invested in longer term higher yielding investments subject to analysis and evaluation of the risks, and to purchase or build up to £30m in physical assets through a new Commercial Property Strategy. The latest actuarial valuation of the Pension Fund has also provided opportunities to prepay pension contributions to generate savings. Consequently this is a time of significant change in treasury management activities and this report provides Members with relevant information in order to make informed decisions.

4.0 PRUDENTIAL INDICATOR PERFORMANCE 2019-20

4.1 The Council has a healthy financial position and this can be demonstrated in its prudential indicator figures. This is forecast to continue in 2019-20 as it is not expected that any external borrowing will be taken out and investment performance is running ahead of budget targets.

4.2 Appendix 1 shows the projected position against the prudential indicator targets that have been agreed for 2019-20. The first indicator shows the ratio of debt financing costs after allowing for investment income compared to the net revenue budget (reflecting treasury management costs as a percentage of expenditure). The GRA forecast level of 2.52% is relatively low, reflecting that the GRA currently has relatively low levels of debt and other long term liabilities given its size. The estimated financing costs on the GRA are lower than the forecast at 1.54%, due to strong investment performance. This reflects a number of factors including having larger than expected cash sums to invest and achieving higher returns on lending to the Development Company, which started part way through the year and which earns a higher rate of interest.

4.3 The HRA forecast level for financing costs of 11.44% is higher than the GRA ratio, as a result of the £88.212m of borrowing that had to be taken out to pay the

government for the introduction of the HRA self-financing system. This borrowing has an interest charge of £3.056m but this can be accommodated within the overall HRA budget position, and the HRA has actually benefitted significantly from the introduction of the self-financing system. Estimated performance on HRA financing costs is broadly in line with forecast.

4.4 The second indicator shown in Appendix 1 is the impact of capital decisions on the Council Tax. The forecast and estimated levels are both shown as nil, as borrowing for capital investment will only be undertaken where the business case has demonstrated a positive rate of return (and so there will be no additional costs that fall against the council tax).

4.5 Table 2 in Appendix 1 details the Indicator in relation to capital expenditure, which falls under the principle of Prudence. The figures represent the total scheme approvals for the capital programme, which were recently considered by Council at its meeting in December 2019. The main message here is that the schemes are fully financed and that the actual expenditure incurred to date is less than the budgetary sums provided so no problems are anticipated.

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, and this will not be possible until Summer 2020.

4.7 Appendix 1 Part B shows that the Council has not breached any of its borrowing limits during the financial year, and it is not expected that any external borrowing will be taken out this 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 and as such the other long term liabilities figure will be zero by this time.

5.0 FORECAST 3-YEAR PRUDENTIAL AND PERFORMANCE INDICATORS

5.1 As well as considering performance in the current year, forecast levels need to be agreed for the next 3 years. The range of indicators reported against has also been expanded to reflect the new regulations in this area, and details are set out in Appendix 2.

5.2 The estimate of ratio of financing costs for the GRA is showing a negative percentage in 2020-21 which means that more investment income is being generated than the financing costs being incurred. This is as a result of the serco interest payments ceasing (para 4.7 details) and also budgeted increases in cash investment returns as a result of SORP.

5.3 Debt to net service expenditure is detailed in appendix 2 for the GRA. The purpose of this PI is to show the amount of gross borrowing in the context of the size of the Council as measured by net service expenditure. This indicator will be influenced by a number of factors going forward including:

- The level of borrowing that will need to be taken out to support lending to the Council's development company. This will fluctuate significantly over time

depending on the timing of when building works start and when sales are generated and further details are provided on a separate report elsewhere on this agenda

- The Skelmersdale Town Centre development will require borrowing to finance the scheme, and it is expected that this will commence in the near future although the timing is unclear
- Borrowing of up to £30m to fund a new Commercial Property Strategy was also agreed through the SORP. This has not been reflected in the PI as the time scales for this strategy require development
- There could be a significant borrowing requirement to fund the rebuilding of Leisure Centres. This has not been reflected in the PI as the funding requirement and timescales have still to be agreed

5.4 As projects move forward and the financial picture develops the implications of the financing arrangements will be reflected in the PIs and future reports on a regular basis. 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. It should also be noted that while the GRA ratio of debt to net service expenditure is expected to increase significantly going forward, it is still well below the HRA level.

5.5 The incremental impact on the Council Tax as a result of the capital programme is estimated to be nil as although there will be borrowing in the future, these would be progressed only if the business case demonstrated that they had at least a neutral effect on the revenue position. The HRA rental levels are subject to regulation and consequently the capital programme will not have a direct effect on the charges levied.

5.6 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 and consequently 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, and when the timing of large scale projects becomes clearer.

5.7 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.'

5.8 The Council should have no difficulty meeting this requirement in 2019-20 nor are any difficulties envisaged for future years. This view takes into account current commitments and existing plans.

5.9 Appendix 2, Part B, details the prudential indicators that are relevant for the purposes of setting an integrated treasury management strategy, including the authorised and operational limits for external debt.

5.10 The authorised limits for external debt 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.

5.11 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.

5.12 Appendix 2 contains details on occupancy levels for different types of Commercial Assets. These relatively high occupancy levels mean that the resultant income streams should be more secure. Avoiding vacancies is important not just from an income generating point of view but also the ability to levy service charges on tenants and to avoid empty business rates liabilities. This appendix also shows income levels for these commercial assets, based upon actual performance and forecast income in the current financial year. This provides trend information on the income levels being achieved.

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.

6.2 HRA Debt Repayments were suspended when the Government required rent reductions to be made for a 4 year period up to March 2020. Now that this period has ended these repayments will be reinstated from the next financial year to ensure that the full £88.212m of HRA external borrowing can be provided for over a 70 year period i.e. the estimated life time of the assets.

6.3 The MRP policy has also been updated to clarify that charges will not start to be made until after building works have been completed rather than during the construction phase. This is an important consideration on Commercial Property schemes where the income to make debt repayments will only start to be generated once the property becomes operational. Similarly going forward MRP charges for new Commercial Property schemes will be determined following a consideration of scheme specific factors and agreed through the annual MRP policy.

7.0 TREASURY MANAGEMENT STRATEGY 2020-21

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 2020/21, some borrowing of this nature may be required.

7.2 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 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 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021
Base Rate	0.75%	0.75%	0.75%	0.75%	0.75%

Public Works Loan Board (PWLB) interest rate on 25 year borrowing 3.02%

7.5 As can be seen from the above table Link are not predicting any base rate rises in 2020/21 and currently it is more likely that interest rates are cut this year rather than increased. This will have an effect on our Treasury Management performance in 2020/21 and will reduce investment return levels when compared with 2019/20. In October 2019 the government increased the cost of borrowing from the PWLB by one percentage point and it's Link's view that rates will continue to rise gradually to around 3.60% by the end of 2020/21.

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 It is anticipated that during 2020/21 there should be on average somewhere in the region of £25m available for total investment, although the level can vary significantly at different times of the year. Following a review of the treasury management function by Red Quadrant as part of SORP, an additional GRA income target of £326,000 has been agreed, on the basis of investing up to £10m in longer term, higher yield assets.

7.8 In order to achieve this target it is proposed that the following new long term (greater than 12 months) investment approaches are adopted:

- Property Funds - Investment up to £3m in individual property funds for a period of up to 5 years

- Corporate bond investments – Investment of up to £3m in individual bonds for a maximum period not exceeding 3 years
- Infrastructure investments e.g. solar bonds – Investment of up to £3m for a period not exceeding 5 years
- Sums can be invested with other Councils for a period of up to 5 years, not exceeding an amount of £5m
- Investments with banks and building societies can be made for a period of up to 3 years as long as the credit rating is A- or above and the sums do not exceed £3m.

7.9 In developing this approach meetings have been held with our treasury advisors, and with colleagues from Warrington Council and Lancashire County Council. Further details on these measures are set out in Appendix 4. These types of investments are made by many local authorities and provide the opportunity to achieve higher rates of return but this means accepting a higher level of risk that funds could be lost. It is intended that these types of investment decision will be approved by the Strategic Assets Purchasing Committee, including redeeming or selling investments at short notice where relevant and appropriate given market conditions.

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. Short term investments of up to 12 months will also continue to be made with Councils and UK based banks and building societies that have an excellent credit rating by the Head of Finance, Procurement and Commercial Property under delegated authority in line with existing arrangements. Performance on these investments will continue to be monitored against the 3 month LIBID interest rate.

7.11 Following the latest actuarial revaluation of the Pension Fund there is an opportunity to prepay pension contributions due over the next 3 years to achieve a revenue saving. This prepayment option was used 3 years ago when the last actuarial valuation was completed and has worked effectively. Consequently it is proposed to pursue this option which would involve prepaying up to £7.74m (this figure may reduce following discussions with the Pension Fund) in April 2020, compared to the estimated normal monthly contributions which would total £8.19m over the three year period. This would save £0.45m over the three year period and would equate to an interest rate of just over 1.8% without any significant risk implications.

BORROWING STRATEGY

7.12 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 at that time.

7.13 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.

7.14 Going forward there will be a need to take on external borrowing to finance a number of key projects as set out above. When the cash flows for these projects has become clearer than appropriate borrowing will be taken out, seeking to source finance from the best available lender, which may be the PWLB or an alternative depending on the most cost effective option available at that time.

7.15 No changes are proposed to the Council's existing capital strategy, which was approved at the Council meeting in February 2019, and which continues to be fit for purpose.

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.

10.0 HEALTH AND WELLBEING IMPLICATIONS

10.1 There are no significant health and wellbeing implications arising from this report.

Background Documents

There are no background documents (as defined in Section 100D(5) of the Local Government Act 1972) to this report.

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 – Prudential Indicator Performance 2019-20
Appendix 2 – Three year prudential indicator Forecasts
Appendix 3 – Minimum Revenue Provision policy
Appendix 4 – Proposed new investment opportunities