AGENDA ITEM NO:

9th October 2019

TREASURY MANAGEMENT STRATEGY 2019/2020 - REVISED

Purpose of the Report

1. This report discusses and asks the Commissioner to approve the proposed new Prudential (PrIs) and Treasury (TrIs) Indicators for the next three years (Appendix A).

2. This is the first time a revised strategy has been produced in year. This reflects the long term review of capital expenditure that has occurred and the proposed strategy that recommends borrowing for significant estates assets over 30 year and ICT investments that have a life of 7 years or more. The updated Indicators are aligned to meet the new long term borrowing requirements set out in the latest Capital Financing Strategy.

Background

3. The Codes of Practice require the Commissioner to consider and approve a Treasury Management Strategy (TMS), which incorporates the Prudential and Treasury Indicators and an Annual Investment Strategy. This is required under the provisions of the latest CIPFA Code of Practice on Treasury Management in the Public Services (the CIPFA Code) and the Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

4. The initial Treasury Management Strategy and Annual Investment Strategy were approved through CMB in April 2019.

5. Advice has been sought from Link Asset Services on the strategy and the cost of borrowing.

Main Considerations for the Commissioner – Treasury Management Strategy

Prudential and Treasury Indicators

6. Previously the Prudential and Treasury Indicators have been of a somewhat theoretical interest, because of our debt-free status. The new Capital Strategy sets out a need for borrowing to finance future Capital plans. The indicators are now more relevant to the PCC, he is responsible for calculating and formally approving these in line with the Prudential Code.

7. Issues of affordability, prudence and sustainability of borrowing are of increased relevance to the PCC now that he will need to borrow to finance the future capital expenditure plan. The PrIs/TrIs for borrowing limits, interest rate exposures and maturity structures have to be considered.

8. The PCC has responsibilities under the Prudential Code to ensure value for money (robust option appraisal) and practicality of capital investment, proper stewardship of assets (asset management planning) and sound links to service objectives.

9. The proposed Prudential and Treasury Indicators are set out in Appendix A, together with a brief summary on each one.

10. The latest Capital Financing Strategy sets out a requirement to borrow over future years. For the next three years planned borrowing is £1.1m (19/20), £3.4m (20/21) and £0.3m (21/22) totaling a cumulative £4.8m. PrI3 considers borrowing requirements against capital expenditure. As borrowing does not exceed the capital expenditure the so called ‘Golden Rule’ is not broken.

11. The key indicator is PrI2, this forecasts the percentage of the organisations net revenue stream being spent on borrowing. Appendix A shows this turning from negative to positive as borrowing costs exceed investment returns in 2021/22. The question to be asked is can the organisation afford the repayment cost. Whilst in 2021/22 the organisation can afford 0.26% this is planned to increase during the 10 year life of the capital plan. It is forecast that in 2027/28 this could grow to 1.3%. Whilst this is not high compared to other organisations it is the year on year impact that needs to be considered. In addition to this increase in borrowing costs RCCO’s (direct revenue contribution to capital) are planned to rise (these could reach £2.6m by 2027-28). On review these increases can be afforded as long as the identified revenue increases (reported in the Capital Financing Strategy) are included, and as accepted as important, in the Medium Term Financial Strategy (MTFS).

12. Appendix A of this paper sets out new operational limits and authorised limits for borrowing with consideration for these amounts.

Cash Deficits and Surpluses

Short Term Deficits and Surpluses

13. Short term cash surpluses and deficits will arise regularly during the year. It is anticipated that the majority of these surpluses will only be available on a very temporary basis. Short term deposits are the most cost effective investment for such cash surpluses. Therefore, investments will normally be made through short term deposits at fixed rates to specific dates, with reference to the cash flow requirements.

14. Temporary loans (where both the borrower and lender have the option to redeem the loan within twelve months) are occasionally used to cover short term revenue cash deficits, where this is more cost effective than temporarily withdrawing funds from call accounts, pending the receipt of, for example, grant income.

15. I therefore recommend that the PCC continues to utilise temporary loans and deposits to manage these cash flows.

Longer Term Cash Balances

16. The longer term balances are managed by Wiltshire Council and are currently held, partly in longer term (above three and up to 12 months) investments and partly in call accounts.

17. The annualised weighted average return of the longer term investments (only) as at 1st April 2019 was 0.76%, which had increased from 0.61% in the same period last year. The Bank of England base rate had been 0.5% since November 2017 and was increased to 0.75% in August 2018. With the increase it is expected that fixed term deposit rates will improve further.

18. A comparative benchmark, (the three month London Interbank Bid Rate LIBID), reflecting the rate at which a bank is willing to borrow from other banks, was, on average 0.65% for the same period.

Risk

19. The Prudential Code has been implemented to allow authorities' and PCC's freedom to invest if they consider it is affordable and prudent, this reduces risk. This paper reviews the indicators and suggests that as long as the MTFS includes the increase in borrowing costs and RCCO then the levels are affordable.

20. In 2019/2020 external advice is being provided by Link Asset Services, this will be surrounding where to lend and how to borrow. The intention is to borrow from the Public Works Loan Board (PWLB) at a fixed interest rate. The PWLB is a statutory body that issues loans to local authorities, and other specified bodies, from the National Loans Fund. As they are a public body rates are often lower than private enterprises. The PWLB is used by most local authorities and PCCs which borrow.

Monitoring and Reporting of the Prudential Indicators

21. Wiltshire Council staff and the finance staff of the PCC will monitor progress against the PrIs/TrIs throughout the year. The PCC will be kept informed of any issues that arise, including potential or actual breaches, as these could be ultra-vires. I will normally update the PCC every six months in the Interim and Annual Treasury Reports.

Collaboration

22. The day to day Treasury Management function is outsourced to Wiltshire Council. Using their skills and contacts with market experts it is believed that value for money is achieved alongside good returns.

Diversity

23. No diversity issues have been identified

Recommendations

24. The Commissioner is asked to:

    a) Note the change in strategy to borrow and agree that increases in the MTFS are affordable in the medium term; and

    b) adopt the new Prudential and Treasury Indicators set out in Appendix A; and

    c) agree that short term cash deficits and surpluses continue to be managed through temporary loans and deposits (paragraphs 13 to 15); and

    d) agree that, for longer term cash balances and borrowing, the Chief Finance Officer continues to be delegated to negotiate the terms and conditions of any external arrangement.

Clive Barker
Chief Finance Officer to the PCC

PRUDENTIAL (PrIs) AND TREASURY (TrIs) INDICATORS 2019/2020 - 2021/2022

Prudential Indicators

PrI 1 - Capital Expenditure

1. The capital expenditure plans are set out in the Capital Plan, but under the Prudential Code, the PCC is required to confirm this as a Prudential Indicator. Capital expenditure plans for the years 2018/2019 to 2021/2022 are as follows (assuming 80% of spend occurs in the year with carry forward):

	2018/2019 Actual £million	2019/2020 Estimate £million	2020/2021 Estimate £million	2021/2022 Estimate £million
Capital Expenditure	5.8	7.9	7.9	6.4

PrI 2 – Ratio of Financing Costs to Net Revenue Stream

2. This indicator expresses the net costs of financing as a percentage of the funding receivable from the Government and council tax payers. The net cost of financing includes interest and principal repayments for long and short term borrowing, as well as other credit-like arrangements, netted off by interest receivable in respect of cash investments. The indicator does not include the revenue contribution to capital expenditure.

3. The table below shows a negative percentage in the early years. This is because interest received is expected to exceed borrowing costs. In 2021/22 cumulative borrowing is expected to be £4.8m resulting in borrowing costs exceeding the interest received. This is expected to rise to 1.3% by 2027/28.

	2018/2019 Actual %	2019/2020 Est. %	2020/2021 Est. %	2021/2022 Est. %
Ratio of Financing Costs to Net Revenue Stream	-0.16	-0.17	-0.13	0.26

PrI 3 – Gross Borrowing to Capital Financing Requirement

4. This indicator measures the so-called 'Golden Rule' and focuses on prudence. To meet the 'Golden Rule' capital expenditure needs to exceed borrowing.

5. The Capital Financing Requirement (CFR) normally increases year-on-year by the amount of capital expenditure that is not funded from sources other than borrowing (i.e. government capital grant, capital receipts, developer contributions, direct revenue), reduced by the amount set-aside from the revenue budget and capital receipts for the repayment of debt. The CFR is equivalent to Gross Borrowing and is the PCC's long and short term external debt.

	2018/2019 Actual £million	2019/2020 Estimate £million	2020/2021 Estimate £million	2021/2022 Estimate £million
Capital Expenditure	5.843	7.854	7.886	6.354
Financing (other than borrowing)	-5.843	-6.722	-4.485	-6.071
Gap to fund from borrowing		1.132	3.401	0.283
MRP (repayments of borrowing)			-0.49	-0.506
Movement in CFR		**1.132**	**3.352**	**-0.223**
Total Capital Financing Requirement		**1.132**	**4.484**	**4.261**

Treasury Management Indicators within the Prudential Code
TrI 1 – External debt

6. Under the Prudential Code, three limits must be set by the PCC for External Debt:
    a) Actuals for last year and an estimate for the end of the current year
    b) An Operational boundary for the next three years
    c) An Authorised limit for the next three years.

7. The Operational boundary is based on the most likely, prudent, but not worst case scenario of borrowing. The Authorised limit is based on the Operational limit but with an additional margin (in the PCC's case a 15% allowance for temporary borrowing and a consideration for the possibility of Capital financing brought forward) to allow for unusual or unexpected cash movements. These borrowing limits are to be set gross of investments.

	31/03/2019 Actual	**31/03/2020 Estimated**
Short Term Borrowing (Temporary)	£0.0m	£0.0m
Long Term Borrowing	£0.0m	£1.1m
Other Long Term Liabilities	£0.0m	£0.0m
TOTAL	**£0.0m**	**£1.1m**

8. There was no temporary borrowing outstanding as at 31 March 2019. It is estimated that there will be no temporary borrowing outstanding at the end of the current financial year.

9. The PCC's Capital Strategy sets out a ten year spending and funding plan. To date the PCC has managed to operate on a debt free basis and has financed its capital requirement from capital grant, capital receipts, the capital reserve, and direct from revenue. For 2019/20 this plan incorporates long term borrowing of £1.132 million in support of significant new Estates investments.

10. The PCC's long term contract surrounding the provision of Estate in Swindon is a PFI. This leads to, in accounting terms, a long term liability which is essentially a form of borrowing. Whilst included as a revenue payment in budgets, accounting practise requires us to split the capital element and report it separately in the Statement of Accounts. The unitary payment will include an amount for interest and capital repayment.

11. The PCC holds its surplus monies in approved investments in sufficient levels to finance its annual cash flow forecasts. However, during each year there are fluctuations in cash flow, the highest deficits are forecast as approximately £6.0 million (2019/2020), £6.5 million (2020/2021) and £7.0 million (2021/2022). There may also be a need to pay out capital expenditure prior to receipt of capital income, although previous experience shows that this is unlikely.

12. Invested cash could be reduced to cover these temporary deficits but this may not be the most cost effective approach for the PCC. Limits for temporary borrowing are therefore proposed, to allow flexibility to use borrowing as an alternative way of financing such temporary deficits, if this is in the PCC's best interest. The following limits should be authorised to deal with possible in-year cash flow shortfalls and to cover the levels of long term borrowing as set out in the latest Capital Financing Strategy.

Operational Boundary	**2019/2020**	**2020/2021**	**2021/2022**
Annual gross borrowing	£1.2m	£4.6m	£4.9m
Temporary borrowing	£5.5m	£6.0m	£6.5m
Total operational boundary	**£6.7m**	**£10.6m**	**£11.4m**

Authorised Limit	**2019/2020**	**2020/2021**	**2021/2022**
Annual gross borrowing	£1.8m	£4.9m	£4.9m
Temporary borrowing	£6.3m	£6.9m	£7.4m
Total authorised limit	**£8.1m**	**£11.8m**	**£12.3m**

Treasury Management Indicators within the Treasury Management Code

TrI 2 – Interest Rate Exposures

13. This TrI relates to net borrowing (i.e. borrowing less investments). As the PCC's long term borrowing will be at fixed rate there is no risk to borrowing costs of a change in interest rates over the term of the loan. There is however a risk of the rates increasing prior to the date that the borrowing is planned. The PCC does rely partly on returns from invested funds in order to finance revenue and capital expenditure.

14. Future returns will be affected by inflation and the Bank of England's decisions on interest rates. The Bank rate was increased to 0.75% in August 2018, prior to this it had remained at 0.5% for a period of 15 months.

15. Link Asset Services, the treasury adviser for the PCC, is currently reporting the following in terms of investment rates,

    a) Investment returns are likely to remain low during 2019/2020 but to be on a gently rising trend over the next few years.

    b) It is unlikely that the Bank Rate will increase from 0.75% ahead of the deadline for Brexit in October. The next increase in Bank Rate is forecast to be in August 2020 and the rate is expected to reach 1.25% in March 2022.

16. Reflecting the low returns in 2017/18 and 2018/19 the PCC's budget in 2019/2020 for investment returns is set on a return of 1%

17. All funds are internally managed by Wiltshire Council and returns will be maximised whichever way interest rates move. The control of the investments is subject to the approved Annual Investment Strategy and the limits set in this TrI.

18. Any temporary or long term borrowing, as authorised in TrI 1 above, should be taken on a fixed interest rate. Investments on HSBC Bank Treasury and other financial institutions should also be taken at fixed interest rates.

The PCC's upper limit for fixed interest rate exposure for the period 2019/2020 to 2021/2022 is 100% of net outstanding principal sums.

The PCC's upper limit for variable interest rate exposure for the period 2019/2020 to 2021/2022 is 0% of net outstanding principal sums.

<u>TrI 3 – Maturity Structure of Borrowing</u>

19. To date the PCC has operated on a debt free basis. The Capital Strategy allows for borrowing of £1.1 million in 2019/2020 and £0.6m in 2020/2021 relating to significant Estates investments. These loans will be taken over a thirty year period to reflect the estimated useful operational life of the asset in ownership of the PCC. Further borrowing of £2.8 million is planned for 2020/21 relating to the mobile communications project which will be taken over a period of 7 years to reflect the general lifespan of IST type assets.

<u>TrI 4 – Total Principal Sums invested for periods longer than 365 days</u>

20. This TrI is covered by the Annual Investment Strategy.