Agenda Item

Report

Report to:	**Executive Committee**
Date of Meeting:	**27 February 2019**
Report by:	**Executive Director (Finance and Corporate Resources)**

Subject:	**Prudential Indicators, Treasury Management Strategy and Annual Investment Strategy 2019/2020**

1. Purpose of Report

1.1 The purpose of the report is to:-

- ♦ provide members with the Prudential Code indicators for 2019/20 to 2021/22,
- ♦ provide members with the Treasury Management Strategy for 2019/20, and
- ♦ provide members with the Annual Investment Strategy for 2019/20.

2. Recommendation(s)

2.1 The Committee is asked to approve the following recommendation(s):-

(1) that the Prudential Code indicators for the period 2019/20 to 2021/22, the Treasury Management Strategy for 2019/20 and the Annual Investment Strategy for 2019/20 be endorsed and referred to Council for formal approval.

3. Background

3.1 Through guidance and regulation the Council is required to produce Prudential Indicators, a Treasury Management Strategy and an Annual Investment Strategy. It has been cited as best practice to combine the information in one document. This paper will therefore cover:

- ♦ Prudential Indicators (Section 4)
- ♦ Treasury Management Strategy (Section 5)
- ♦ Annual Investment Strategy (Section 6)

4. Prudential Code Indicators

4.1 The Prudential Indicators for 2019/2020 to 2021/2022 are shown at Appendix 1 along with explanations for each indicator. An updated position for 2018/2019 is also included.

4.2 Through these Prudential Indicators we are laying out what our expectations are for the coming year, and setting limits based on these expectations. A report will be presented to Committee later this year showing actual achievement against the 2018/2019 indicators.

4.3 The first three indicators show details of capital expenditure, how this will be funded and set limits for external borrowing. The fourth indicator demonstrates the financial impact of the expected borrowing and that this is affordable.

Capital Expenditure and Asset Management

4.4 The Prudential Framework for local authority capital investment was introduced through the Local Government (Scotland) Act 2003 with the aim of supporting strategic planning for capital investment at a local level.

4.5 It was through the introduction of the Code that Councils are now able to take responsibility for deciding an affordable level of borrowing to fund capital expenditure. This moves away from the previous regime through which central government gave councils consent to borrow defined amounts for capital expenditure.

4.6 The level of capital expenditure that we choose to fund through borrowing has a direct impact on the treasury activities of the Council. The majority of funding for the Primary School Investment Programme is to be funded from borrowing. Borrowing is also required to fund investment in Roads Carriageways and Infrastructure and for the Housing Investment Programme. Borrowing will also be used in the short term to manage the cashflow funding gap for City Deal. The Prudential Indicators show the level of borrowing required.

4.7 An update to the General Fund programme for 2019/20 was presented to the Executive Committee on 21 November 2018, and it allows for investment across priorities consistent with the objectives of the Council Plan including:-

- Improve achievement, raise educational attainment and support lifelong learning
- Ensure schools and other places of learning are inspirational
  - Continuation of the Primary Schools Modernisation Programme
- Improve the road network, influence improvements in public transport and encourage active travel
  - Continuation of the Roads Investment Programme
- Improve later life
  - Social Work Residential Facilities Programme

4.8 The capital expenditure for 2019/20 is based on the aforementioned report and takes account of anticipated expenditure for that year. The funding package includes levels of General Capital Grant for 2019/2020 as advised by the Scottish Government.

4.9 In relation to 2020/2021 and 2021/2022, the Scottish Government have not yet issued grant estimates. For the purpose of these indicators, a General Capital Grant of £28m has been assumed for each of these two years, in line with the Capital Strategy agreed by the Executive Committee on 21 November 2018. This is a prudent assumption based on the approximate 2018/2019 General Capital Grant allocation, which was the most recent information available at that point in time.

4.10 It should be noted that the programme also includes projects which will be funded by Specific Capital Grants from the Scottish Government.

4.11 The Future Capital Investment Strategy, setting out the basis for a medium term Capital Investment Strategy, covering a period of 10 years was approved by the Executive Committee on 21 November 2018. For financial years 2020/21 and 2021/22, estimated capital programmes based on this strategy have been included.

4.12 The HRA capital programme for 2019/20 was presented to a Special Meeting of Housing and Technical Resources Committee on 6 February 2019. For financial years 2020/21 and 2021/22, estimated capital programmes based on the HRA business plan have been included.

4.13 Housing capital expenditure will result in an increase in the availability of social housing stock through the new build programme and improvements in the quality of the existing social housing stock. Future capital programmes will also include investment in housing stock to reflect the new Energy Efficiency Standard for Social Housing (EESSH) which must be achieved by 31 December 2020. At present, 89.9% of the Council's houses are compliant with the EESSH standard.

4.14 The Prudential Code also recognises that in making capital investment decisions the authority should be informed by sound asset management planning and options appraisal.

4.15 When considering potential capital investment, the Council ensures that the objectives of capital investment fit within the Council strategic plans and that the investment is informed through the asset management planning process. The following asset management plans were updated for 2018 and approved by the relevant resource Committees.

- 2018 Property and Housing Asset Management Plans presented to Housing and Technical Resources Committee 31 October 2018
- Fleet Asset Management Plan 2018 presented to Community and Enterprise Resources Committee 21 August 2018
- 2018 Information and Communication Technology (ICT) Asset Management Plan presented to Finance and Corporate Resources Committee 19 September 2018
- Roads Asset Management Plan – 2018 Update presented to Community and Enterprise Resources Committee 21 August 2018

5. Treasury Management Strategy

5.1 The Treasury Management Strategy for 2019/20 is detailed at Appendix 2.

5.2 The Council's treasury activities are regulated by statute, and a professional code of practice (the CIPFA Treasury Management in Public Services Code of Practice). It is a requirement of this Code, and the financial regulations of South Lanarkshire Council that a Treasury Management Strategy is approved by Committee every year.

5.3 The Treasury Management Code was updated in December 2017 mainly to cover Non Treasury Investments such as investment property portfolios and has little impact on this Council.

5.4 The Treasury Management in the Public Services - Guidance Notes for Local Authorities details treasury management indicators that are to be reported within the Treasury Strategy.

5.5 The level of borrowing required to fund the Council's Capital programme, together with the variable nature of interest rates increases the risks associated with the treasury management function. As a result the Council will take a cautious approach to its Treasury Strategy by setting treasury management indicators to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of adverse movements in interest rates.

5.6 The indicators set limits on the maturity structure of borrowing and limits on investments over 364 days.

5.7 The main areas covered by the Strategy are:-
- Debt and Investment Projections
- Expected Movement in Interest Rates
- Borrowing Strategies
- Statutory Repayment of Loans Fund Advances

5.8 Total external net debt is expected to reach £1,109.752m by the end of 2018/19. This is gross debt of £1,274.941m less estimated investments of £165.189m. The estimated level of investments reflects the level of reserves held plus an element of working capital.

5.9 External debt includes the liability of £208.921m that is included on the Council's balance sheet for the Secondary Schools and finance leases under International Financial Reporting Standards. It should be noted that while these liabilities are to be classed as external debt, there is no requirement to borrow these amounts and there is therefore no impact on borrowing costs.

6. Annual Investment Strategy 2019/20

6.1 The Annual Investment Strategy for 2019/20 has been included at Appendix 3.

6.2 The Local Government Investments (Scotland) Regulations 2010 provides a formal investment framework for Councils. It provides greater autonomy for local authorities in their investment activities but with this greater freedom comes greater responsibility and the onus is on local authorities to act prudently with regard to their investment and treasury management activities.

6.3 The Council can decide what investment tools it will class as permitted investments in the coming year. The Regulations require an Annual Investment Strategy detailing the permitted investments to be approved by the Council.

6.4 The two fundamental principles of the Investment Regulations are that:-

- Councils are required to manage their investments and deposits in a way that minimises the risk to the capital sum and optimises the return on the funds consistent with those risks. Security should be considered first, then liquidity, and lastly the yield or return.

- Councils are able to determine what investments they may make, including both the type and duration of the investment.

6.5 The Annual Investment Strategy is considered to be central to the Regulation. The Council is required to prepare an Annual Investment Strategy prior to the start of the financial year.

6.6 The Regulations require the Council to consider its investment activity as a whole. This includes a range of investments, which covers the depositing of temporary surplus funds with banks and similar institutions, shareholdings in companies or joint ventures, loans to group undertakings and third parties. It also covers investment properties

6.7 The Council is required to set out a strategy for investments that explains investment objectives and policies including any special circumstances applying to them that have led to a particular approach.

6.8 The attached strategy identifies the different types of treasury risk that investments are exposed to and the controls in place for limiting those risks. These include restrictions on who the Council will invest with and on the period of investment.

6.9 The Council is required to set out in the strategy the types of investment that it will permit in the financial year. These will be known as "permitted investments".

6.10 The strategy also limits the amounts that may be held in such investments at any time in the year.

6.11 After consideration of the Council's requirements to manage funds and our approach to risk, no changes have been made to the permitted investments previously agreed for 2018/19.

6.12 The Executive Director of Finance and Corporate Resources will ensure that the strategy is adhered to at all times. The Council can only make an investment if that type of investment is detailed in this Strategy.

6.13 **Borrowing in Advance** Borrowing in advance of need increases the level of funds which require to be invested or deposited.

6.14 The CIPFA Prudential Code is clear that the Council must not borrow more than, or in advance of needs purely in order to profit from the investment of the extra sums borrowed.

6.15 The Council needs to be able to demonstrate that borrowing is for a legitimate purpose such as the exercise of day to day cash management or the management of borrowing for capital purposes.

6.16 The regulations do not prevent borrowing in advance of need but for it to be allowed the Council must detail its policy for borrowing in advance in the strategy.

6.17 The Executive Director of Finance and Corporate Resources will ensure that borrowing is taken at the most appropriate time to ensure best value and that the requirements of the Prudential Code are met.

7. Employee Implications

7.1 None.

8. Financial Implications

8.1 There are no direct funding implications arising from the production of the Prudential Indicators, Treasury Management Strategy or Annual Investment Strategy.

8.2 The financial impact from treasury activity and borrowing for capital expenditure has been built into the long term revenue budget strategy.

9. Other Implications

9.1 South Lanarkshire Council recognises that any treasury management activity will carry an element of risk. It is important that risk is identified and controls put in place to limit those risks.

9.2 The preparation and approval of Prudential Indicators and the Treasury Management Strategy set a framework for treasury management activities and limits on debt in order to mitigate risks.

9.3 The CIPFA Treasury Management Code of Practice adopted by the Council, places Credit and Counterparty risk at the forefront of treasury risks.

9.4 South Lanarkshire Council recognises that any investment activity will carry an element of risk. It is important that risk is identified and controls put in place to limit and manage those risks.

9.5 Section 5 of the Annual Investment Strategy details how South Lanarkshire Council will manage these risks.

9.6 There is no requirement to carry out an environmental impact assessment in terms of the information contained within this report.

9.7 There are no implications for sustainability in terms of the information contained in this report.

10. Equality Impact Assessment and Consultation Arrangements

10.1 This report does not introduce a new policy, function or strategy or recommend a change to an existing policy, function or strategy and, therefore, no impact assessment is required.

10.2 There is no requirement to undertake any consultation in relation to the content of the report.

Paul Manning
Executive Director (Finance and Corporate Resources)

19 February 2019

Link(s) to Council Values/Ambitions/Objectives

- Accountable, effective, efficient and transparent

Previous References

- None

List of Background Papers

- None

Contact for Further Information

If you would like to inspect the background papers or want further information, please contact:-

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Appendix 1

Prudential Indicators 2019/20 – 2021/22

The Prudential Indicators are shown below and are split into 2 categories:

- Capital Expenditure and External Debt
- Affordability

Indicators 1 to 3 show statements of the expected borrowing requirement for the years 2018/19 to 2021/22 and attributes limits for external borrowing.

Indicator 4 demonstrates the financial impact of the expected borrowing for the years 2018/19 to 2021/22 and that this borrowing is affordable.

After year end, the actual position for the Indicators will be reported to this Committee.

Capital Expenditure and External Debt Indicators

1. Prudential Indicator 1 – Capital Expenditure

1.1 This indicator states the capital expenditure plans for the years 2018/19 through to 2021/22. The indicator takes account of the anticipated spend for 2018/19 and 2019/20 along with the Capital Strategy information for future years.

	2018/19 Estimate £ m	**2019/20 Estimate £ m**	**2020/21 Estimate £ m**	**2021/22 Estimate £ m**
General Fund Capital Expenditure	**66.819**	**71.740**	**134.327**	**68.884**
Funded by:				
Borrowing	29.395	16.215	82.435	16.881
Capital Receipts and Grants	35.169	54.314	51.892	52.003
Contributions from Reserves	2.255	1.211	0.000	0.000
Total Funding	**66.819**	**71.740**	**134.327**	**68.884**
HRA Capital Expenditure	**53.664**	**61.945**	**78.147**	**25.433**
Funded by:				
Borrowing	21.602	26.932	30.907	1.891
Capital Receipts and Grants	8.332	14.129	26.163	0.720
Revenue Contributions	23.730	20.884	21.077	22.822
Total Funding	**53.664**	**61.945**	**78.147**	**25.433**

1.2 The table overleaf summarises the above capital expenditure plans and how the borrowing required for the capital programmes are adjusted for loans fund principal repayments, maturing debt and borrowing not taken in prior financial years to derive the borrowing requirement for the Council in each financial year.

	2018/19 Estimate £ m	2019/20 Estimate £ m	2020/21 Estimate £ m	2021/22 Estimate £ m
Borrowing for General Fund Capital Expenditure	29.395	16.215	82.435	16.881
Borrowing for HRA Capital Expenditure	21.602	26.932	30.907	1.891
Total Borrowing for Capital Expenditure	**50.997**	**43.147**	**113.342**	**18.772**
Less Loans Fund Principal Repayments	(25.286)	(28.019)	(22.834)	(25.385)
Plus Maturing Debt	22.381	30.590	29.893	40.954
Borrowing carried over/(taken) in prior financial years	134.419	(1.729)	0.000	0.000
Total Borrowing Requirement	**182.511**	**43.989**	**120.401**	**34.341**
Actual/Expected Borrowing	**184.240**	**43.989**	**120.401**	**34.341**
Borrowing carried over to next financial year	(1.729)	0.000	0.000	0.000

1.3 At the time when borrowing was taken, the Council had a borrowing requirement of £184.240m, however due to re-profiling of the capital programme this has reduced by £1.729m to £182.511m. The borrowing will meet the capital costs that will now be incurred in 2019/20.

1.4 The borrowing identified above and associated costs have been included in the Council's Financial Strategy.

2. Prudential Indicator 2– Councils Borrowing Need (the Capital Financing Requirement) and Gross Debt

2.1 The Council's Capital Financial Requirement (CFR) is the total outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying need to borrow for past and present capital expenditure.

2.2 The Council is required to pay off an element of the accumulated balance of borrowing every year through a charge to the revenue account.

2.3 In order to ensure that over the medium term debt will only be for a capital purpose, the Council needs to ensure that debt does not, except in the short term, exceed the total of the Capital Financing requirement (CFR) in 2018/19 plus the estimates of any additional CFR for 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

2.4. The projected Capital Financing Requirement and Gross Debt is shown in the table below

	2018/19 Estimate £ m	2019/20 Estimate £ m	2020/21 Estimate £ m	2021/22 Estimate £ m
General Fund Capital Financing Requirement	1,033.484	1,020.012	1,078.161	1,069.152
HRA Capital Financing Requirement	239.728	260.850	285.505	280.448
Total Capital Financing Requirement	1,273.212	1,280.862	1,363.666	1,349.600
Gross Debt	1,274.941	1,280.862	1,363.666	1,349.600
Difference	(1.729)	0.000	0.000	0.000

2.5 It can be seen that the estimated gross debt levels for the period 2018/19 to 2021/22 do not exceed the forecast CFR at the end of 2021/22, demonstrating that borrowing will only be undertaken for capital purposes.

2.6. This indicator sets out the expected CFR based on the capital plans shown at Indicator 1. Actual CFR for 2018/19 will be presented to committee following year end.

3. Prudential Indicator 3 – Limits to Borrowing

3.1 The **Operational Boundary for external debt** is based on the expected maximum external debt that could be faced in the course of the year. It is set to accommodate the borrowing requirements as detailed at Prudential Indicator 1, and also includes sufficient scope to allow for changes to the capital programme throughout the year and to borrow for the following year should this be considered appropriate. This limit is permitted to be breached during the year. This would be reported in the Prudential Indicators report presented to Committee after year end.

3.2 The **Authorised Limit for External Debt** represents a limit beyond which external debt is prohibited. It represents the level of external debt which could be afforded in the very short term, but is not sustainable in the longer term without consideration to revenue budgets. This limit needs to be set or revised by the full Council who should also be advised if the limit is exceeded or is expected to be exceeded. Again the limits include scope to borrow for the following year should this be considered appropriate.

	2018/19 Estimate £ m	2019/20 Estimate £ m	2020/21 Estimate £ m	2021/22 Estimate £ m
Operational Limit for debt	1,140.000	1,240.000	1,240.000	1,260.000
Operational Limit for other liabilities	220.000	210.000	210.000	200.000
Operational Limit	1,360.000	1,450.000	1,450.000	1,460,000
Authorised Limit for debt	1,160.000	1,260.000	1,260.000	1,280.000
Authorised Limit for other liabilities	220.000	210.000	210.000	200.000
Authorised Limit	1,380.000	1,470.000	1,470.000	1,480,000

Affordability Indicators

4. Prudential Indicator 4 – Ratio of Financing Costs to Net Revenue Stream

4.1. This indicator focuses on the extent to which the Council's net revenue budget is used for servicing debt. This is shown for both General Fund and HRA. The figures for General Fund include the reduction in the PPP/Finance Lease Liability as a financing cost.

	2018/19 Estimate £ m	2019/20 Estimate £ m	2020/21 Estimate £ m	2021/22 Estimate £ m
General Fund Ratio of Financing Costs to Net Revenue Stream (expressed as %)	8.76%	9.40%	9.12%	9.55%
HRA General Fund Ratio of Financing Costs to Net Revenue Stream (expressed as %)	16.82%	17.77%	18.34%	18.27%

4.2. While the Council has prepared a Financial Strategy for 2019/20 to 2021/22, we have not been advised of our General Revenue Grant funding beyond 2019/20. The indicators have been calculated using the assumptions regarding reductions in grant levels built into the Financial Strategy for 2019/20 to 2021/22.

Appendix 2

Treasury Management Strategy 2019/20

1. Foreword

1.1. The treasury management function is an important part of the overall financial management of the Council's affairs. The treasury management function considers the effective funding of capital investment plans and works toward ensuring that best practice is followed when making decisions on managing Council deposited funds.

The Council's treasury activities are regulated by the Local Government (Scotland) Acts 1975 and 2003, and a professional code of practice (the CIPFA Code of Practice on Treasury Management – revised December 2017). It is a requirement of this Code, and the financial regulations of South Lanarkshire Council, that a Treasury Management Strategy is approved by Committee every year.

A key requirement of this strategy is to explain both the risks and the management of these risks associated with the treasury function. A further report will be produced after the year end to report on actual activity during the year. It is a requirement of the Treasury Management Code of Practice that a mid year monitoring report is produced. This will cover the period 1 April 2019 to 30 September 2019 and will be submitted to Committee after that date.

This strategy covers:

- The Council's debt and investment projections (Section 2)
- The Council's estimates and limits on future debt levels (Section 3)
- The expected movement in interest rates (Section 4)
- The Council's borrowing strategy (Section 5)
- Treasury Management Limits on Activity (Section 6)
- Statutory Repayment of Loans Fund Advances (Section 7)

2. Debt and Investment Projections 2018/19 – 2020/21

2.1 The expected levels of external borrowing and investment for 2019/20 to 2021/22 are shown in the table below. An updated position for 2018/19 is also shown.

	2018/19 Estimate £ m	**2019/20 Estimate £ m**	**2020/21 Estimate £ m**	**2021/22 Estimate £ m**
External Debt				
Borrowing	£1,066.020	£1,079.419	£1,169.927	£1,163.314
Other long term liabilities	£208.921	£201.443	£193.739	£186.286
Debt at 31 March (including PPP/Finance Lease Liability)	£1,274.941	£1,280.862	£1,363.666	£1,349.600
Investments				
Total Investments at 31 March	£165.189	£163.460	£163.460	£163.460

3. Estimates and Limits on Future Debt Levels

3.1 There are a number of key indicators to ensure the Council operates its activities within well defined limits. These are detailed in the Prudential Indicators Appendix 1, paragraphs 2.1 to 3.2.

4. Expected Movement in Interest Rates

4.1 The interest rate forecasts provided by the Council's treasury advisor, Link Asset Services and by Capital Economics are reproduced below. Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The forecasts below will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year.

Medium Term Interest rates - Annual Averages – Link Asset Services

	Base Interest Rate	5 year PWLB	10 year PWLB	25 year PWLB	50 year PWLB
2019/20	1.063%	2.250%	2.675%	3.100%	2.900%
2020/21	1.375%	2.500%	2.950%	3.350%	3.150%
2021/22	1.813%	2.725%	3.150%	3.550%	3.350%

Medium Term Interest rates - Annual Averages – Capital Economics

	Base Interest Rate	5 year PWLB	10 year PWLB	25 year PWLB	50 year PWLB
2019/20	1.125%	2.500%	2.900%	3.375%	3.225%
2020/21	1.417%	2.833%	3.100%	3.433%	3.400%

4.2 Public Works Loans Board (PWLB) rates and gilt yields have continued to be influenced by economic data. It is likely that this will continue for the foreseeable future. The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently.

4.3 The differential between investment earnings and debt costs remains high and is expected to continue in 2019/20. This "cost of carrying" needs to be considered if borrowing is taken before our cash flow requires funds as returns on deposits will be lower than the rate paid on borrowing.

5. Borrowing Strategy

5.1 The Council's strategy is to maintain maximum control over its borrowing activities as well as flexibility on its loans portfolio. Capital expenditure levels, market conditions and interest rate levels will be monitored during the year in order to minimise borrowing costs over the medium to longer term. A prudent and pragmatic approach to borrowing will be maintained to minimise borrowing costs without compromising the longer-term stability of the portfolio, consistent with the Council's Prudential Indicators.

5.2 In conjunction with advice from its treasury advisor, Link Asset Services, the Council will keep under review the options it has in borrowing from the PWLB, the market and other sources up to the available capacity within its CFR and Authorised Limit.

5.3 One of the options to finance capital borrowing is the issuance of Bonds. In the right circumstances, Bonds could be appropriate for the Council but are dependent on the level of borrowing, the repayment period and the mix of other funding sources to fund a large scale capital programme. To date, their use has not been considered appropriate or necessary given the amount the Council requires to borrow and the repayment period of the borrowing. Moving forward, they will remain an option and will be considered along with other sources of borrowing as required.

5.4 Alongside fixed rate maturity borrowing, other options such as variable rate or short term borrowing or EIP (equal instalments of principal) loans that help mitigate the impact of the cost of carry are all active considerations.

5.5 Any decision to borrow at low, variable rates of interest would only be taken after considering the level of longer term interest rates and the extent of variable rate earnings on the Council's investment balances. Longer term rates are regularly assessed relative to the cost of carry benefits of shorter term and variable rate alternatives.

5.6 The Council will continue to maintain a flexible policy on debt rescheduling. Market volatility may provide opportunities for rescheduling debt from time to time. The rationale for rescheduling would be one or more of the following:

- Savings in interest costs with minimal risk
- Balancing the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio
- Amending the profile of maturing debt to reduce any inherent refinancing risks.

5.7 To manage potential rescheduling activity the Council's debt portfolio will be monitored against equivalent interest rates and available refinancing options on a regular basis. As opportunities arise, they will be identified by Link Asset Services and discussed with the Council's officers.

5.8 All rescheduling will comply with the accounting requirements of the Local Authority SORP and Statutory requirements of the Scottish Government's Guidance on Local Authority Accounting Proper Accounting Practices dated 30 March 2007.

5.9 The overall strategy for borrowing will be to monitor interest rates, undertake planned borrowing at the best time, whilst investigating opportunities where possible to improve the management of our existing loan portfolio.

5.10 The expected borrowing requirement is detailed in the Prudential Indicators Appendix 1, paragraphs 1.1 to 1.3 and is summarised below.

	2018/19 Estimate £ m	**2019/20 Estimate £ m**	**2020/21 Estimate £ m**	**2021/22 Estimate £ m**
Total Borrowing Requirement	**182.511**	**43.989**	**120.401**	**34.341**

6. Treasury Management Limits on Activity

6.1 The Treasury Management in the Public Services - Guidance Notes for Local Authorities details treasury management indicators that are to be reported within the Treasury Strategy.

6.2 CIPFA consulted on proposals to make changes to the treasury management indicators. More guidance on the detail of these changes was made available when the update of the CIPFA Publication Treasury Management in the Public Services Guidance Notes for Local Authorities was published in August 2018.

6.3 The requirement to set upper limits on fixed and variable rate exposures was removed and the limit on the maturity structure of borrowing was revised to include all borrowing rather than just fixed rate borrowing.

6.4 The purpose of the Treasury Management Indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The indicators are detailed below.

Treasury Management Indicator 1 – Maturity Structure of Borrowing

6.5 By setting limits on the maturity structure of borrowing, the exposure to large concentrations of debt needing to be replaced at the same time in the future at currently unknown rates can be limited. This effectively places a limit on exposure to longer term interest rate movement. The upper and lower limits for the maturity structure of borrowing is shown in the table below.

Maturity Structure of Borrowing		
	Upper Limit	**Lower Limit**
Under 12 months	25%	0%
12 months and 24 months	30%	0%
24 months and 5 years	50%	0%
5 years and 10 years	50%	0%
10 years and 20 years	60%	0%
20 years and 30 years	70%	0%
30 years and 40 years	80%	0%
40 years and 50 years	90%	0%
50 years and above	90%	0%

Treasury Management Indicator 2 – Maturity Structure of Borrowing

6.6 Limits on the total principal sums invested for greater than 364 days protects against potential loss that we would suffer if we required to get our money back earlier than the full term of the investment.

6.7 This Council will, at any one time, have no more than £10m invested for periods greater than 364 days, subject to a maximum period of 5 years.

Interest Rate Risk

6.8 As there is no longer a specific recommended indicator in respect of interest rate exposures, councils are asked to explain their strategy for managing interest rate risks.

6.9 Interest rate risk is the risk that movements in interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately.

6.10 The Council manages this risk by having a view of the future course of interest rates and a borrowing strategy that aims to minimise borrowing costs and ensure that these are affordable. The financial impact of borrowing for capital expenditure has been built into the long term revenue budget strategy.

Credit Risk

6.11 There is no specific recommended indicator in relation to credit risk, although the Treasury Management Code states that authorities may wish to design and set their own indicators in relation to this.

6.12 Details of how South Lanarkshire Council manages credit risk are included in the Annual Investment Strategy 2018/19 which is included in Appendix 3 of this report.

7. Statutory Repayment of Loans Fund Advances

7.1 The Scottish Government introduced The Local Authority (Capital Financing and Accounting) Scotland Regulations 2016 with effect from 1 April 2016. These regulations require the statutory loans fund to be administered in accordance with the 2016 Regulations, proper accounting practice and prudent financial management.

7.2 The Council is required to set out its policy for the statutory repayment of loans fund advances prior to the start of the financial year. The repayment of loans fund advances ensures that the Council makes a prudent provision each year to pay off an element of the accumulated loans fund advances made in previous financial years.

7.3 A variety of options are provided to councils so long as a prudent provision is made each year. The Council is recommended to approve the following policy on the repayment of loans fund advances:-

For loans fund advances made before 1 April 2016, the policy will be to maintain the practice of previous years and apply the **Statutory Method**, with all loans fund advances being repaid by the annuity method.

For loans fund advances made after 1 April 2016, the policy for the repayment of loans advances will be to use the most appropriate method of repayment for individual capital schemes or projects from the following methods while taking into consideration the capital expenditure plans and associated revenue implications that the Council had committed to, prior to the introduction of the Regulations coming into force on 1 April 2016.

1. **Statutory method** – loans fund advances will be repaid by the annuity method. The Council is permitted to use this option for a transitional period only, of five years until 31st March 2021, at which time it must change its policy to use alternative approaches based on asset life periods or a funding/income profile.

2. **Asset life method** – loans fund advances will be repaid with reference to the life of an asset using either the equal instalment or annuity method.

3. **Funding / Income profile method** – loans fund advances will be repaid by reference to an associated income stream.

7.4 The annuity rate applied to the loans fund repayments will be the loans fund interest rate – a measure of the average cost of funding capital advances to services in year.

7.5 Decisions taken each year on new advances create a liability to repay those advances from future years' budgets. The Council is required to report on the commitment to repay loans fund advances. This is shown in the following tables.

General Fund	Opening Balance	New Advances	Repayments	Closing Balance
2018/19	812.896	29.395	-19.868	822.423
2019/20	822.423	16.215	-22.209	816.429
2020/21 – 2023/24	816.429	165.388	-73.839	907.978
2024/25 – 2028/29	907.978	18.357	-145.459	780.876
2029/30 – 2033/34	780.876	0.000	-175.270	605.606
2034/35 – 2038/39	605.606	0.000	-145.132	460.474
2039/40 – 2043/44	460.474	0.000	-147.407	313.067
2044/45 – 2048/49	313.067	0.000	-154.365	158.702
2049/50 – 2053/54	158.702	0.000	-108.095	50.607
2054/55 – 2058/59	50.607	0.000	-42.325	8.282
2059/60 – 2063/64	8.282	0.000	-8.178	0.104
2064/65 – 2068/69	0.104	0.000	-0.104	0.000

Housing Revenue Account	Opening Balance	New Advances	Repayments	Closing Balance
2018/19	223.531	21.602	-5.418	239.715
2019/20	239.715	26.932	-5.810	260.837
2020/21 – 2023/24	260.837	34.051	-27.287	267.601
2024/25 – 2028/29	267.601	0.600	-42.267	225.934
2029/30 – 2033/34	225.934	0.000	-49.440	176.494
2034/35 – 2038/39	176.494	0.000	-47.840	128.654
2039/40 – 2043/44	128.654	0.000	-30.475	98.179
2044/45 – 2048/49	98.179	0.000	-35.719	62.460
2049/50 – 2053/54	62.460	0.000	-36.238	26.222
2054/55 – 2058/59	26.222	0.000	-21.548	4.674
2059/60 – 2063/64	4.674	0.000	-4.660	0.014
2064/65 – 2068/69	0.014	0.000	-0.014	0.000

Appendix 3

Annual Investment Strategy 2019/2020

1. Background

1.1. Local authority investment activity is regulated by statute. In Scotland the legislation that local authorities rely on to make investments has consisted of the Trustee Investments Act 1961 and the Local Government (Scotland) Act 1973.

1.2. In response to representation from local authorities that the existing regulation was too prescriptive, provision was made in the Local Government in Scotland Act 2003 for Scottish Ministers to introduce a new regulatory framework.

1.3. Section 40 of the Local Government in Scotland Act 2003 provides local authorities with the power to invest money. This power may be exercised in accordance with regulations made by Scottish Ministers under this section.

1.4. Scottish Ministers have, through Consent and Regulations, provided a formal investment framework, namely The Local Government Investments (Scotland) Regulations 2010 which came into force on 1 April 2010.

1.5. The new regulatory framework introduced by regulations made by Scottish Ministers under Section 40, provides greater autonomy for local authorities in their investment activities. With this greater freedom comes greater responsibility and the onus is on local authorities to act prudently with regard to their investment and treasury management activities.

1.6. Local authorities are required to manage their investments in a way that minimises the risk to the capital sum and optimises the return on the funds consistent with those risks.

1.7. Local authorities are required to prepare an Annual Investment Strategy before the start of the financial year.

2. Investment Policy and Strategy

2.1. Scottish Ministers have identified two CIPFA Codes of Practice which local authorities must have regard to in managing their investments:

- Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (Fully Revised Second Edition 2009)

- The Prudential Code for Capital Finance in Local Authorities (Fully Revised Second Edition 2009)

2.2. The first Code referenced covers the whole range of treasury management issues including the fundamental principles for making and managing investments. The second Code deals with capital investment but also includes guidance on Treasury Management.

2.3. The CIPFA Treasury Management Code and the CIPFA Prudential Code were updated in December 2017. There are no significant areas of change in the revised codes that would impact on our investment strategy.

2.4. This Council in its Treasury Management Policy Statement defines its Treasury Management Activities as:-

The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

2.5. The main objective when investing surplus funds will therefore be the security of the transaction. The Council must also meet its liquidity requirement and only invest for the period of time that is prudent. Finally, and only after consideration of security and liquidity, the yield that will be gained from the investment will be considered.

3. Treasury Management Risks

3.1. The CIPFA Treasury Management Code of Practice adopted by the Council includes a section on Managing Treasury Management Risks, placing Credit and Counterparty risk at the forefront of treasury risks.

3.2. South Lanarkshire Council recognises that any investment activity will carry an element of risk. It is important that risk is identified and controls put in place to limit those risks.

3.3. Risks when carrying out investment activities can broadly be categorised as follows:

Credit Risk:	failure to receive back the principal and interest on an investment in full and on the due date
Liquidity Risk:	the maturity or terms of the investment are such that insufficient cash is available in the short term
Market Risk:	the effect of market prices on the value of the investment

4. Permitted Investments

4.1. Local authorities are required to list and document all types of investments that they will permit in the financial year. These will be described as the permitted investments for that local authority.

4.2. Local authorities are required to state the limits for the amounts which at any time during the year may be invested in each type of permitted investments, such limit being applied when the investment is made.

4.3. For each type of permitted investment the objectives of that investment are to be identified along with the associated treasury risks and the controls that will be put in place to limit those risks.

4.4. The permitted investments that South Lanarkshire Council have identified for the financial year 2019/20 are detailed in Annex 1 to this strategy and listed below:

- Deposits with the Debt Management Account Deposit Facility
- Deposits with UK Local Authorities
- Deposits with Banks and Building Societies
- Certificates of Deposit with Banks and Building Societies
- UK Government Gilts and Treasury Bills
- AAA Rated Bonds Issued by Multilateral Development Banks
- AAA Rated Money Market Funds
- Loans to Third Parties

Inclusion as a permitted investment simply allows the Council to use that investment if considered to be appropriate. It is not necessarily the case that all permitted investments will be used.

5. Risk Management

5.1. The CIPFA Treasury Management Code of Practice adopted by the Council includes a section on Managing Treasury Management Risks, placing Credit and Counterparty risk at the forefront of treasury risks. The Code states:

Credit ratings should only be used as a starting point when considering credit risk. Organisations should make use of generally available market information, such as the quality financial press, market data, and information on government support for banks including the ability and willingness of the relevant government to provide adequate support.

5.2. In managing credit and counterparty risk the Council will be required to:

- Establish a sound diversification policy with high credit quality counterparties
- Set clear minimum credit limits for counterparties.
- Have regard to the credit ratings issued by all three rating agencies and make decisions based on the lowest rating
- Consider country, sector and group limits
- Regularly review credit ratings and other creditworthiness indicators as outlined in 5.6 below and act upon forward looking rating warnings

Deposits with the Debt Management Account Deposit Facility

5.3. Deposits with the Debt Management Office Account Deposit facility provided by HM Treasury will be continued. This facility offers the highest security for investments and deposits will be subject to a maximum period of six months which is the maximum time allowed by the DMO and no maximum deposit size.

Deposits with UK Local Authorities

5.4. Deposits with UK local authorities, joint boards and passenger transport executives will be permitted subject to a maximum period of three years and a maximum deposit size of £15m for up to 364 days and £10m beyond this.

Deposits and Certificates of Deposit with Banks and Building Societies

5.5. The following minimum thresholds will be applied to all deposits with banks and building societies, including Certificate of Deposits.

Rating Agency	Long Term Rating	Maximum Deposit
Fitch	A-	£10m
Moody’s	A3	£10m
Standard and Poors	A-	£10m

5.6. Prior to depositing funds with any bank or building society, additional indicators of creditworthiness (such as short term and secondary credit ratings, credit default swaps, Gross Domestic Product (GDP); net debt as a percentage of GDP, potential sovereign and parental support, share price) will also be considered.

5.7. Banks on negative rating watch with any credit rating agency will be heavily scrutinised before any deposit is made with that institution.

5.8. Currently all deposits are with UK institutions. Non UK banks would only be considered if they meet our strict criteria, and are recommended by our advisers. Any one foreign country would carry a limit of £10m deposits.

5.9. In the event that two or more organisations in the same group meet the criteria detailed in 5.5. then a group limit of £10m will be applied.

5.10. Deposits with banks or building societies will be restricted to 364 days.

5.11. The existing Counterparty policy sets out a sound approach to depositing cash in normal market circumstances. Whilst this policy still stands, the Executive Director of Finance and Corporate Resources may consider temporarily restricting deposits to those counterparties considered of higher credit quality than the minimum criteria set out in the policy.

5.12. Examples of these restrictions would be greater use of higher rated institutions; increased use of the DMO account and restricting the term of deposits as appropriate.

5.13. Operational banking will continue with our contracted provider. Any deposits with banks or building societies will continue to meet the criteria set in 5.5.

UK Government Gilts and Treasury Bills

5.14. UK Government Gilts and Treasury Bills are bonds issued by HM Treasury. Purchasing these bonds is a means of investing in the UK Government. The UK Government has never failed to make interest or principal payments on these bonds.

5.15. Investments in UK Government Gilts and Treasury Bills carry very little credit risk as they are investments in the UK Government. Gilts and Treasury Bills are marketable and the price fluctuates from day to day. There is therefore the potential of capital loss if sold ahead of maturity. Gilts and Treasury Bills will be bought by the Council with the intention of holding them to maturity thereby mitigating market risk. There will be no maximum limit to the amount that will be invested in UK Gilts or Treasury Bills for maturities of less than one year. For Gilts with maturities in excess of one year a limit of £10m will be applied and no maturity will exceed five years.

AAA Rated Bonds Issued by Multilateral Development Banks

5.16. These are bonds issued by supranational institutions such as the World Bank or the European Investment Bank.

5.17. Investments in AAA rated bonds issued by Multilateral Development Banks carry very little credit risk as they are backed by several Sovereign States. These bonds carry market risk as their price fluctuates from day to day. There is therefore the potential of capital loss if sold ahead of maturity. These bonds will be bought by the Council with the intention of holding them to maturity, thereby mitigating market risk. The maximum amount that will be invested in AAA rated bonds issued by Multilateral Development Banks is £10m with a maximum period of five years.

5.18. Any investments in these bonds would only be undertaken after careful consideration and with advice from our advisers to ensure security of our investments.

AAA Rated Money Market Funds

5.19. Investments in Money Market Funds will be limited to those funds rated as AAAmmf by Fitch, Aaa by Moody's or AAAm by Standard and Poor's. In the event that the Money Market Fund is rated by more than one credit rating agency, each rating must meet the set criteria.

5.20. In addition to the credit rating, Money Market Funds will also be assessed for suitability on fund size, the strength of the custodian and the stability of invested capital.

5.21. Selection of suitable Money Market Funds will be undertaken in consultation with our advisers.

5.22. Investments in Money Market Funds will be restricted to 0.5% of the Money Market Fund size and to no more than £10m in any individual Money Market Fund.

5.23. Investments in Sterling Government Money Market Funds which only invest in Sterling denominated debt securities issued by the UK Government will be restricted to 2% of the Money Market Fund size and to no more than £10m in any individual Money Market Fund.

Loans to Third Parties

5.24. Any new types of loans to third parties should be approved by Members through the appropriate Committee with full consideration of the service rationale behind the loan and the likelihood of partial or full default and the impact that this will have on service budgets.

Liquidity Risk

5.25. In order to manage liquidity risk, the Council will endeavour to maintain a minimum balance of £5m in bank accounts and money market funds with instant access (same day notice account). This is dependent on these facilities continuing to be provided by the banks and subject to our minimum lending criteria.

5.26. In addition to retaining a balance of deposits on instant access, South Lanarkshire Council will maintain an appropriate overdraft facility.

5.27. Longer term investments will only be considered where the Council's liquidity requirements are ensured and an assessment of liquidity risk has been carried out. No more than £10m of investments at any one time will be for a period in excess of 364 days.

6. Borrowing In Advance

6.1. Borrowing in advance may be taken if it is considered appropriate. Borrowing in advance of need would increase the level of deposits and investments. When considering borrowing in advance, the risks of holding increased level of investments against the risk of adverse interest rate movements if borrowing was deferred will be assessed.

6.2. The risks of holding increased levels of deposits and investments would be managed in accordance with section 5 above. The Council has unlimited access to using the DMO Deposit Facility where necessary. This facility offers the highest security for investments.

7. Investment Projection 2019/20 – 2021/22

7.1. Over the period 2019/20 – 2021/22, it is estimated that an average level of investments of approximately £163m will be required to be managed, reflecting the level of reserves held plus an element of working capital. It is recognised that this is only an estimate and that this figure will vary according to cash flow movements and the timing and size of any borrowing taken.

7.2. Regardless of the level of deposits, the main consideration when investing surplus funds will be the security of the transaction. The Council must also meet its liquidity requirement and only invest for the period of time that is prudent. Finally, and only after consideration of security and liquidity, the yield that will be gained from the investment will be considered.

8. Prudential Indicators

8.1. The regulations require that the Annual Investment Strategy contains details of the relevant prudential indicators for investments.

8.2. The Treasury Management Code requires local authorities to set an upper limit for each forward financial year period for investments longer than 364 days. The purpose is to contain the exposure to the possibility of loss that might arise as a result of having to seek early repayment of principal sums invested.

8.3. No more than £10m may be invested for periods in excess of 364 days and that the maximum period for any investment is 5 years.

9. Common Good Investments

9.1. The regulations require local authorities to identify separately the permitted investments relating to the Common Good.

9.2. All investments relating to the Common Good funds administered by South Lanarkshire Council are cash investments in South Lanarkshire Council. These investments are not considered to have any significant risk attached.

Permitted Investment	Treasury Risks	Mitigating Controls	Limits
Deposits with the Debt Management Account Deposit Facility	This is a deposit with the UK Government and so credit risk is very low. Liquidity risk has to be considered as deposits can only be broken with the agreement of the counterparty and penalties may apply. There is no market risk as the principal sum invested is not affected by market prices.	There are no mitigating controls required.	There is no maximum monetary limit. A maximum term of deposit of six months as set by the Debt Management Office.
Deposits with UK Local Authorities and other bodies defined as local authorities in the Local Government Scotland Act 2003 (And Equivalent English Act)	These are considered to be quasi UK Government investment and as such credit risk is very low. Liquidity risk has to be considered as deposits can only be broken with the agreement of the counterparty and penalties may apply. There is no market risk as the principal sum invested is not affected by market prices.	There are no mitigating controls required.	The maximum deposit with any local authority will be £15m for deposits less than one year. Deposits in excess of one year will be subject to a maximum term of deposit of three years and be limited to £10m.
Deposits with Banks and Building Societies	These tend to be low risk but credit risk will be higher than deposits placed with the DMO or UK local authorities. Liquidity risk has to be considered as deposits can only be broken with the agreement of the counterparty and penalties may apply. There is no market risk as the principal sum invested is not affected by market prices.	The counterparty selection criteria restricts lending only to high quality counterparties, measured initially by credit ratings from Fitch, Moody's and Standard and Poors. Additional indicators of creditworthiness will also be considered prior to placing any deposits. Liquidity risk can be controlled by the use of instant access call accounts.	The maximum deposit with any bank or building society will be £10m. A maximum term of deposit of 364 days.

Certificates of Deposit with Banks and Building Societies	These are short to medium term dated marketable securities issued by financial institutions. These tend to be low risk investments but credit risk will be higher than deposits placed with the DMO or UK local authorities. Liquidity risk is lower than placing a deposit with a Bank or Building Society as these can be sold on the market. There is a risk of capital loss arising from selling ahead of maturity.	The counterparty selection criteria restricts lending only to high quality counterparties, measured initially by credit ratings from Fitch, Moody's and Standard and Poor's. Additional indicators of creditworthiness will also be considered prior to using this type of instrument. Market risk would be mitigated by holding the instrument to maturity.	The maximum investment with any bank or building society will be £10m. A maximum period of investment of 364 days.
UK Government Gilts and Treasury Bills	These are marketable securities issued by the UK Government and as such credit risk is very low. Liquidity risk is very low as there is a huge market for Gilts and Treasury Bills There is a risk of capital loss arising from selling ahead of maturity.	There are no mitigating controls required for credit risk as the investment is with the UK Government. Market risk would be mitigated by holding the instrument to maturity.	There is no maximum limit to investments in UK Gilts or Treasury Bills for maturities less than one year and a limit of £10m for maturities greater than one year. The maximum period of investment will be five years.
AAA Rated Bonds Issued by Multilateral Development Banks	These are bonds issued by supranational bodies such as the European Investment Bank or World Bank and as a result are backed by several sovereign states and as such credit risk is very low. Liquidity risk is very low as there is a large market for Supranational Bonds. There is a risk of capital loss arising from selling ahead of maturity.	As the investment is effectively spread across a number of sovereign states, the Council will mitigate the credit risk of holding such bonds by considering the sovereign rating of the underlying sovereign states and only holding bonds that have a AAA rating. Market risk would be mitigated by holding the instrument to maturity.	The maximum amount that will be invested in AAA Rated Bonds issued by Multilateral Development Banks is £10m. The maximum period of investment will be five years.

AAA Rated Money Market Funds	Money market funds are pooled funds that invest in short-term money market instruments and other debt instruments. The underlying investments are diversified and Credit risk, liquidity risk and market risk are all very low. Investments in these MMFs are highly liquid (same day liquidity).	Money Market Funds will only be used where they have obtained a AAA rating from the credit rating agencies. In addition to the credit rating, Money Market Funds will also be assessed for suitability on fund size, the strength of the custodian and the stability of invested capital.	Investments in Money Market Funds will be limited to 0.5% of the Money Market Fund Balance and to no more than £10m in any one Fund. Investments in Sterling Government Money Market Funds which only invest in Sterling denominated debt securities issued by the UK Government will be restricted to 2% of the Money Market Fund size and to no more than £10m in any individual Money Market Fund.
Loans to Third Parties	These are service investments which may exhibit credit risk and are likely to be highly illiquid.	Any new types of loans to third parties should be approved by Members through the appropriate Committee with full consideration of the service rationale behind the loan and the likelihood of partial or full default and the impact that this will have on service budgets.	