PERTH & KINROSS COUNCIL

10 May 2023

TREASURY & INVESTMENT STRATEGY and PRUDENTIAL INDICATORS 2023/24 – 2027/28

Report by the Head of Finance
(Report No. 23/135)

1. PURPOSE OF REPORT

1.1 This report details the Council's proposed Treasury Strategy for 2023/24 to 2027/28, the Investment & Property Strategy for 2023/24 and Prudential Indicators for 2023/24 to 2027/28.

2. RECOMMENDATIONS

2.1 It is recommended that the Council:

- Notes the contents of this report.
- Approves the five year Treasury Strategy for 2023/24 to 2027/28, as detailed in this report, which is submitted in accordance with the Council's approved Treasury Management Practices (TMP).
- Approves the Permitted Investments and Investment Strategy for 2023/24 outlined at Section 7 and detailed at **Appendix III** of this report.
- Approves the Property Investment Strategy for 2023/24 outlined at Section 8 and detailed at **Appendix IV** of this report.
- Approves the proposed Prudential Indicators for 2023/24 to 2027/28, as outlined at Section 11 and detailed at **Appendix V** of this report.

3. STRUCTURE OF REPORT

3.1 This report is structured over the following sections:

Section 4 – The Council's current Treasury position
Section 5 – Prospects for interest rates
Section 6 – Capital requirements and the borrowing strategy 2023/24 to 2027/28
Section 7 – The Investment Strategy 2023/24
Section 8 – Investment properties 2023/24
Section 9 – Debt Rescheduling Opportunities
Section 10 – The Prudential Code
Section 11 – Prudential Indicators 2023/24 to 2027/28
Section 12 – Conclusion

3.2 The Treasury and Investment Strategy details the expected activities of the Council's treasury function for the relevant financial years. Its submission to the Council is a requirement of the Council's approved Treasury Management Practices (TMPs) and is also a requirement under the CIPFA Code of Practice for Treasury Management. The Investment Strategy details the Permitted Investments of the Council, and outlines the risks associated with the expected investment activities. The submission of an annual Investment Strategy is a requirement of the Local Government Investments (Scotland) Regulations 2010.

3.3 In determining the Treasury Strategy, the Council is required to review its Prudential Indicators. The Council approved the Composite Capital Budget for the five years to 2027/28 at its meeting on 1 March 2023 (report 23/73 refers). This report also proposes updated Prudential Indicators for the five years 2023/24 to 2027/28 in line with the five year Capital Delivery Programme approved by the Council.

4. THE CURRENT TREASURY POSITION

4.1 In order to put the proposed Treasury Strategy for 2023/24 to 2027/28 into context, the Council's treasury position at the start of the financial year as at 31 March 2023 is shown below:

		PRINCIPAL AMOUNT (£million)	AVERAGE RATE (%)
Fixed Rate	• Public Works Loan Board (PWLB)	560.0	2.40
	• Market Bonds	0.1	0.00
		560.1	2.40
Variable Rate	• Short Term Market Loans	0.0	0.00
	• Market Bonds	43.2	4.59
	• Local Loans	5.4	3.76
		48.6	4.49
PFI/PPP	• PFI/PPP Contracts	121.3	5.10
TOTAL GROSS DEBT		**730.0**	**2.99**
TOTAL SHORT-TERM MARKET INVESTMENTS		**(173.7)**	**(3.76)**
TOTAL NET DEBT		**556.3**	**2.75**

4.2 The projected Borrowing Requirement for each of the next five years, which is a significant determinant of treasury activity, is summarised below. This reflects the approved Capital expenditure within the Council's Composite and Housing Investment Programme Budgets which is to be funded by new borrowing.

£ million	2023/24	2024/25	2025/26	2026/27	2027/28	Total
Borrowing Requirement	155.7	184.8	108.0	65.4	59.5	573.4

4.3 The above figures are based upon the Composite Capital Budget and the Housing Revenue Account Capital Investment Programme for 2023/24 to 2027/28. The above figures do not take account of the estimated annual borrowing requirement carried forward between years in order to match cashflow requirements. However, they do highlight the front loading of the Council's planned Capital expenditure.

5. PROSPECTS FOR INTEREST RATES

5.1 The Council's treasury adviser, Link Asset Services Ltd, assists the Council in formulating a view on interest rates. **Appendix I** shows forecasts of the Bank Base Rate (or short-term/variable rates) and longer-term PWLB fixed interest rates, whilst **Appendix II** shows the forecast in graphical form. As can be seen, a further increase in the Bank Base Rate is expected this year before falling steadily in subsequent years. The forecast also shows that longer-term rates are currently anticipated to be around their peak, subject to short term fluctuations.

5.2 The Monetary Policy Committee (MPC) increased the Bank Base Rate further to 4.25% at its most recent meeting on 23 March 2023. The increases in the Bank Base Rate over the last year have been in response to the significant rise in inflation over the period. Whilst inflation shows signs of peaking at present at around 10% and is expected to fall significantly in the next year, recent figures still show that inflation remains persistently high. Therefore, it is anticipated that there will be a further rise in the Base Rate before it starts reducing towards the end of the year as inflation falls.

5.3 Longer term interest rates are expected to follow as similar pattern. However, the unwinding of the Bank of England's monetary policy of measures to stimulate economic activity and the money supply, known as Quantitative Easing (QE), also puts upward pressure on interest rates. Consequently, subject to periods of volatility, the forecast for UK interest rates shows a steady decline over the remainder of this year, however, at a slower rate than short terms rates.

5.4 The Council's borrowing costs are largely determined by the Public Works Loan Board's (PWLB) interest rates, which in turn are determined by the yield on UK Government gilts. Gilt yields have been at higher levels throughout the last year, primarily due to high levels of inflation. The rates available during

2023/24 are expected to remain higher than they had been in the previous years despite being forecast to gradually fall.

5.5 As with any forecast, the above interest rate expectations are subject to variation. The main sensitivities of the above forecast are likely to be as follows:

- A sharper fall in long term rates which could occur, for example, if economic growth or inflation was lower than forecast. This could arise if economic demand was subdued in the aftermath of the cost-of-living crisis.
- A sharp rise in both long and short-term rates could occur if, for example, economic growth recovered faster than expected, or if inflation didn't fall as expected, or increased further, as the economy recovers.

5.6 Interest rate forecasts throughout the period covered by the Capital Programme must be considered, particularly when determining the most appropriate timing for new borrowing. This is particularly the case as the Council's current Borrowing Requirement is significantly higher than historic levels, much of which is required in the earlier years of the current five year programme.

5.7 The current forecasts indicate that short term borrowing will continue to be less expensive than longer term borrowing over the next few years. However, longer term borrowing gives budget certainty and reduces the refinancing risk in later years.

6. CAPITAL REQUIREMENTS AND BORROWING STRATEGY

6.1 The Council requires significant levels of new borrowing over the next few years to fund the Capital Budget. Following the advance borrowing at extremely low rates undertaken in 2019/20 and 2021/22 there is no immediate need or expectation to borrow until late in 2023/24 based on current planned expenditure. Therefore, new borrowing in advance of this timeframe would only be undertaken if capital expenditure were to be incurred earlier than projected, or if opportunities arose to borrow at low rates. Short term temporary borrowing can also be used to meet any immediate cashflow requirements where long-term borrowing is deferred.

6.2 The previous low interest rates and long-term cost certainty provided by fixed rate PWLB borrowing make this the most cost-effective source of financing of capital expenditure. However, given the recent increases in PWLB rates, other institutions, and market instruments available to the Council may be used where appropriate. Examples include the UK Infrastructure Bank which currently offers finance to UK local authorities at below PWLB rates for qualifying infrastructure projects aligned to the UK Government's Net Zero objectives. Market instruments may also allow borrowing to be agreed in advance and drawn down at prescribed future dates (usually up to three years ahead). Therefore, alternative sources of borrowing will be evaluated and considered where they offer savings or other advantages over prevailing PWLB borrowing.

6.3 The Council's Treasury Strategy is based on being "risk-aware" and the Council will actively seek to manage its treasury risks. The Council's borrowing position will continue to be reported on an ongoing basis as part of the Quarterly Treasury Activity and Compliance reports.

6.4 The Council's borrowing strategy will be continuously reviewed and may change if there are unexpected movements in interest rates. This could impact the borrowing strategy as follows:

- If there was a faster fall in long term rates than expected, long-term borrowing in advance of immediate need may be considered.
- If there was an unexpected sharp rise in long term rates, fixed-rate funding would be deferred further, and short-term borrowing used to meet any immediate needs. Longer term borrowing would be considered in future when longer term rates fell from their peaks.

6.5 The Prudential Code requires authorities to detail their strategy on gross and net debt where there is a significant level of both investments and borrowing. It is not possible, nor desirable, to have no investments due to the daily variations in the Council's cashflow position or following the borrowing of long-term debt. The level of investments may also increase where there are significant levels of short-term Reserves. The Council's level of investments had increased significantly following the increased level of long-term borrowing undertaken in recent years. The level of investments has, however, fallen over the last year and is anticipated to steadily reduce further over the next year in line with the delivery of the Capital Programme.

7. INVESTMENT STRATEGY 2023/24

7.1 The requirement to set an annual Investment Strategy is determined by the Local Government Investments (Scotland) Regulations 2010. These requirements include specifying the Permitted Investments of the Council and setting an annual strategy, identifying the risks associated with the strategy and the reporting requirements.

7.2 The proposed Permitted Investments of the Council are shown at **Appendix III**. These reflect low risk investment products and, together with the application of the approved Lending & Investment Policy (*TMP4, Schedule 4.6 Approved Lending & Investment Policy*), ensure investments are only made with low-risk counterparties.

7.3 **It is not proposed to make any changes to the Permitted Investments for 2023/24, including the range of investment instruments or monetary limits. The current limits ensure that the Council always maintains sufficient liquidity and a spread of investments, whilst the specific counterparty list is reviewed continuously by the Head of Finance in light of credit rating changes and other market information.**

7.4 Details of how investments are managed are contained in the Treasury Management Practices (TMPs). The TMPs are reviewed annually, whilst the treasury policies are reviewed continuously in light of prevailing economic and market conditions. It should be noted, however, that the TMPs are to be reviewed later this year to update the arrangements which have been put in place to maintain a robust control environment given the move to hybrid working.

7.5 The Council generally only invests short-term cashflow surpluses. Such investments in total are unlimited, as they are determined by cashflow balances. However, investments are limited with each counterparty to ensure any risk is spread.

7.6 Longer term investments may arise where the Council has significant cash-backed reserves or following borrowing in advance of need within the determined Capital Financing (Borrowing) Requirement. This has been the case in the last two years following the increased level of borrowing, with some funds placed on deposit for up to 24 months. Longer term investments potentially carry greater counterparty risk and a higher market risk of adverse movements in interest rates. Therefore, such investments are limited to £45 million in total and up to a maximum of three years and are only undertaken after consideration of cashflow and interest rate forecasts to determine the optimum duration. With the increased need for new borrowing over the coming years, it is anticipated that there will be no investments undertaken for more than one year.

7.7 The level of investments is anticipated to fall gradually over the current financial year. There are fixed deposits maturing throughout the year, and more of these will be applied to meet ongoing capital expenditure and not re-invested as the year progresses. The total level of investments at the start of the current financial year was £173.65 million which is anticipated to be the peak, subject to daily variations, unless further new borrowing is undertaken during the year or if the profile of the Council's expenditure during the year changes.

7.8 It is anticipated that the following type of investments will be used by the Council in 2023/24:

- Money Market Funds (MMFs),
- Bank deposits on instant access or notice terms,
- Fixed deposits up to 12 months with banks
- Other local authority lending.

7.9 Fixed deposits are generally used for cashflow surpluses which are not required within the next month, whilst investment in MMFs, instant access or notice accounts vary in line with daily fluctuations in the Council's cashflow in order to meet more immediate needs. The amounts in each are dependent on several factors, such as changes in cashflow, including long term borrowing, available rates and market opportunities which may arise. This strategy is reviewed continuously in light of updated economic forecasts and market developments.

Local Authority Lending and Borrowing

7.10 In common with most Councils, Perth & Kinross Council both undertakes short-term borrowing from and lends to other local authorities across the UK as permitted investments. Local authorities are not immune from financial difficulties and there is specific provision for the reporting and management of these situations in relation to English local authorities known as a Section 114 notice. However, unlike commercial entities, the winding-up of a local authority in England or Scotland can only be authorised by the UK or Scottish Parliament respectively. This statutory underpinning means that local authorities cannot go bankrupt and, therefore, present a very low to negligible counter-party investment risk.

Loans to Third Parties

7.11 The Permitted Investments also include loans to third parties. Such loans will be constrained by virtue of the Service having to meet all costs related to such loans. All individual loans to third parties must be approved by Council.

7.12 The submission of Quarterly Treasury and Compliance reports to the Finance & Resources Committee provide elected members with regular updates on the Council's Treasury and Investment activities and an opportunity to exercise scrutiny over the Council's Treasury Management arrangements throughout the year.

7.13 The Common Good Funds operate with relatively small cash balances and with no other financial investments. The Common Good Committees also have authority to grant loans to third parties, and these are included as Permitted Investments. However, the granting of such loans in practice is rare, with each individual proposed loan requiring the specific approval of the relevant Common Good Committee. It is proposed that investments with the Perth & Kinross Council Loans Fund, together with third party loans, remain the only Permitted Investments for the Common Good Funds. It is not proposed to change the terms under which the Common Good Funds place deposits with the Loans Fund.

7.14 In addition, the Common Good Funds hold various properties which generate rental income, and which are therefore deemed to be Investment Properties, and covered by the investment regulations.

7.15 Investments made by any charity or trust administered by the Council are not within the scope of the Investment Regulations and this Strategy. However, any other Council funds that are managed by external investment managers would be covered by this strategy, and the investment manager would therefore be bound by this Investment Strategy in relation to those funds. It is not proposed to use any external investment manager during 2023/24, other than for the Council's charitable funds.

8. INVESTMENT PROPERTIES 2023/24

8.1 Properties held solely to earn rental income and/or for capital appreciation, and not used by the Council for service delivery or administrative purposes, are also covered by the Investment Regulations. Accordingly, an additional permitted investment category of "Investment Property" has been included in the list of Permitted Investments. The Council's initial limit was established as "unlimited", and this remains unaltered.

8.2 Budgeted gross income from the portfolio in 2022/23 was £1,812,000, with the out-turn expected to be £1,868,000. The strategy action plan for the rationalisation of the commercial property portfolio remains on programme. Accordingly, the projected income for 2023/24 is £1,866,000.

8.3 The Annual Property Investment Strategy 2022/23 is attached at Appendix IV and covers property purchased or managed for the following purposes:

- Socio Economic e.g. precinct shops and community facilities
- Economic development e.g. Industrial Estates and workshop units
- Revenue generation e.g. St Johns Centre head lease

8.4 The overall aim of the attached Property Investment Strategy for Perth & Kinross Council is to support the objectives of the Corporate Plan 2018 - 2023 and in doing so, it meets the requirements of the Regulations.

9. DEBT RESCHEDULING

9.1 Debt rescheduling involves prematurely repaying existing loans and replacing them with new loans at current interest rates. Any savings in interest costs, however, must be assessed against the premium payable to the lender to compensate for their loss of interest. The amount of premium payable to the PWLB is calculated based on the difference in the interest rate on the existing loan and the prevailing interest rates for new borrowing. The main benefits of undertaking rescheduling include:

- Generating interest savings, without exposing the Council to additional risk,
- Ensuring a better-balanced maturity profile and volatility ratio in the portfolio,
- Reducing the level of investments, where no replacement borrowing is undertaken.

9.2 The PWLB's premature repayment terms mean that any early redemption of existing PWLB loans is likely to be prohibitively expensive and unlikely to generate savings, even whilst rates for new borrowing are currently at higher levels. Further, the low average rate and maturity profile of the Council's long-term debt mean that it is unlikely that the current portfolio will offer any further significant opportunities. Consequently, there is unlikely to be any debt rescheduling undertaken in 2023/24. The position will, however, continue to be monitored to identify any opportunities which may arise.

10. THE PRUDENTIAL CODE

10.1 The Prudential Code requires the Council to set Prudential Indicators for at least the next three years to ensure that the Council's plans are affordable, sustainable and prudent. To improve longer term strategic and forward planning, the Council maintains Prudential Indicators for the entire period of the approved Capital Budget, currently five years to 2027/28.

10.2 The Council has a statutory duty (under the Local Government in Scotland Act 2003) to determine, and keep under review, how much it can afford to allocate to Capital expenditure. The level of Capital Financing Costs (Loan Charges) strongly influences the level of capital expenditure funded by borrowing and, therefore, the size of the ongoing Capital programme. Effective and proactive Treasury Management aims to minimise these costs and their impact on the overall finances of the Council, whilst not exposing the Council to undue risk. Adverse movements in interest rates, for example, would directly impact on the level of Capital expenditure which is affordable and sustainable.

11. PRUDENTIAL INDICATORS 2023/24 to 2027/28

11.1 The principal means of monitoring and controlling adherence to the Council's capital and treasury plans, and ensuring that they remain affordable, sustainable and prudent, is the determination and monitoring of Prudential Indicators. These Indicators must relate to, and be consistent with, the Council's approved Capital Budget and Treasury Management Strategy.

11.2 The proposed Prudential Indicators for 2023/24 to 2027/28 are shown at **Appendix V** and are based upon the five-year Composite Capital Budget approved by the Council on 1 March 2023 (report 23/73 refers) and the five-year Housing Capital Investment Programme approved by the Housing and Social Wellbeing Committee on 25 January 2023 (report 23/9 refers).

11.3 The ratio of estimated Loan Charges: Net Revenue Stream is a measure of the proportion of the Revenue Budget required to be set aside to meet ongoing borrowing costs in future years. The estimates show these to be on a rising trend, increasing from their current level of 6.4% to 8.7% by 2027/28.

11.4 The Indicators also include estimates of the Council's estimated capital expenditure and the underlying need to borrow for a Capital purpose (Capital Financing Requirement or Borrowing Requirement) and ensure that the borrowing periods are consistent with the type of Capital expenditure being funded.

11.5 The maximum level of external borrowing that the Council can incur, known as the Authorised Limit, is currently £1.2 billion for each year from 2022/23 to 2027/28. Most of the additional borrowing approved by the Council in March 2023 was drawn down from the existing borrowing contingency already included, with the remaining approved new borrowing being contained within existing headroom. Therefore, this limit does not need to be increased at this time. Accordingly, the limit remains consistent with the funding strategy for the Council's Capital plans, Loans Fund estimates and the Medium-Term Financial Plan. It is based on total gross external borrowing and long-term liabilities under PPP/PFI arrangements and takes account of when the borrowing requirement is at its peak over the period.

11.6 All the Indicators comply with the CIPFA Code of Practice for Treasury Management in the Public Services, and will continue to be included and monitored through the Quarterly Treasury Activity & Compliance reports.

12. CONCLUSION

12.1 Treasury operations are undertaken within a dynamic and volatile environment, which can significantly affect both the cost of borrowing and returns from investment. Net annual interest charges in 2022/23 were approximately £14 million (General Fund and Housing Revenue Account combined) and are projected to rise significantly to around £33.5 million by 2027/28. This increase will be managed using the Council's Capital Fund. The setting of an appropriate strategy is, therefore, essential in ensuring that the Council is not exposed to undue risks and costs. The strategy outlined in this report is designed to ensure that the Council achieves the best possible returns on its borrowings and investments, whilst seeking to minimise risk in light of prevailing and forecast market conditions.

12.2 The Investment Strategy outlined in this report covers all matters required by the Investment Regulations, and lists the proposed Permitted Investments for 2023/24. These will be reviewed on an ongoing basis as the economic environment changes and/or new investment products are introduced into the financial markets. However, at this time, the proposed Permitted Investments remain unchanged and there are no proposed changes to investment limits, nor to the definition of approved counterparties.

12.3 The Investment Strategy, in conjunction with the Treasury Management Practices (TMPs), also includes references to the various risks associated with investments, how these will be controlled, and the considerations and procedures to be followed. Security and liquidity of sums invested remain the primary objectives over investment income. The proposed Permitted Investments carry a low level of risk.

12.4 The report also outlines the link between Treasury Management and the Capital Budget. Accordingly, the report proposes revised Prudential Indicators for the years 2023/24 to 2027/28 consistent with the Council's currently approved Capital Budget. The Prudential Indicators include the Council's Authorised Limit for borrowing, which is proposed to remain unchanged at £1.2 billion.

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ANNEX

1. IMPLICATIONS, ASSESSMENTS, CONSULTATION AND COMMUNICATION

Strategic Implications	Yes / None
Community Plan / Single Outcome Agreement	None
Corporate Plan	Yes
Resource Implications	
Financial	Yes
Workforce	Yes
Asset Management (land, property, IST)	Yes
Assessments	
Equality Impact Assessment	Yes
Strategic Environmental Assessment	Yes
Sustainability (community, economic, environmental)	Yes
Legal and Governance	None
Risk	None
Consultation	
Internal	Yes
External	None
Communication	
Communications Plan	None

1. Strategic Implications

<u>Corporate Plan</u>

1.1 The Council's Corporate Plan 2022 – 2027 lays out seven outcome focussed strategic objectives which provide clear strategic direction, inform decisions at a corporate and service level and shape resources allocation. They are as follows:

- Tackling Poverty
- Tackling climate change and supporting sustainable places
- Growing a sustainable and inclusive local economy
- Enabling our children and young people to achieve their full potential
- Protecting and caring for our most vulnerable people
- Supporting and promoting physical and mental wellbeing
- Placing communities at the heart of how we work

1.2 This report relates to all of these objectives.

2. Resource Implications

<u>Financial</u>

2.1 There are no direct financial implications arising from this report other than those reported within the body of the main report.

Workforce

2.2 There are no direct workforce implications arising from this report.

Asset Management (land, property, IT)

2.3 There are no direct asset management implications arising from this report other than those reported within the body of the main report.

3. Assessments

Equality Impact Assessment

3.1 Under the Equality Act 2010, the Council is required to eliminate discrimination, advance equality of opportunity, and foster good relations between equality groups. Carrying out Equality Impact Assessments for plans and policies allows the Council to demonstrate that it is meeting these duties.

3.2 The information contained within this report has been considered under the Corporate Equalities Impact Assessment process (EqIA) and has been assessed as **not relevant** for the purposes of EqIA.

Strategic Environmental Assessment

3.3 The Environmental Assessment (Scotland) Act 2005 places a duty on the Council to identify and assess the environmental consequences of its proposals.

3.4 The information contained within this report has been considered under the Act. However, no action is required as the Act does not apply to the matters presented in this report.

Sustainability

3.5 Under the provisions of the Local Government in Scotland Act 2003 the Council has to discharge its duties in a way which contributes to the achievement of sustainable development. In terms of the Climate Change Act, the Council has a general duty to demonstrate its commitment to sustainability and the community, environmental and economic impacts of its actions.

3.6 The information contained within this report has been considered under the Act. However, no action is required as the Act does not apply to the matters presented in this report.

4. Consultation

4.1 The Chief Executive and the Council's Treasury advisors, Link Asset Services, have been consulted in the preparation of this report.

2. BACKGROUND PAPERS

2.1 No background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973 (other than any containing confidential or exempt information) were relied on to any material extent in preparing the above report.

3. APPENDICES

Appendix I – Outlook for Interest Rates.

Appendix II – Forecast for Interest Rates (Link Asset Services Ltd).

Appendix III – Permitted Investments 2023/24.

Appendix IV – Property Investment Strategy 2023/24

Appendix V – Prudential Indicators 2023/24 to 2027/28