All Committee meetings were cancelled with effect from 23rd March, 2020 due to the COVID-19 emergency.

The recommendations in this report were approved by an Executive Director of the Council, acting under delegated authority in terms of paragraph 2.1.1 of the Council's List of Officer Powers

Approved by Executive Director (Finance and Corporate Services) –

10th April, 2020

Treasury Management and Investment Strategies 2020-23

Report by:	Eileen Rowand, Executive Director (Finance and Corporate Services)
Wards Affected:	All

Purpose

To outline the revised Treasury Management Strategy and Investment Strategy of the Council.

Recommendations

The Policy and Co-ordination Committee is asked to: -

i) approve the Treasury and Investment Strategies;
ii) approve the Statutory Repayment of Loans Fund Advances Policy; and
iii) approve the implementation of the revised Loans Fund Advances Policy from 2019-20 onwards.

Resource Implications

This strategy will help ensure the effective management of the Council's cashflows, lending and borrowing activities and facilitates the funding of the Council's Capital Plan.

Legal & Risk Implications

Legislation - Local Government in Scotland Act 2003 and the Local Government Investments (Scotland) Regulations 2010.

The Council is required to comply with the CIPFA Prudential Code and Treasury Management Code of Practice. Implementation of this strategy will ensure that this requirement is met and that risks are controlled and mitigated.

Impact Assessment

An Equalities Impact Checklist is not required because the report does not propose a change or revision to existing policies and practices.

Consultation

Link Asset Services – Fife Council's Treasury Advisers

1.0 Background

1.1 The treasury management function ensures the Council's cash is organised in accordance with the relevant professional codes so that sufficient cash is available to meet service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities.

1.2 The Treasury Management Strategy (Appendix A) outlines the Council's prudential and treasury indicators as well as current and projected debt levels. The annual investment strategy is also included.

1.3 The strategy has been prepared with the support of the Council's treasury adviser, Link Asset Services, and reflects the current Capital Investment Plan 2020-29 and the Revenue Budget for 2020-21 and the Housing Revenue Account Capital Investment Plan as approved at the Fife Council meeting on 27th February, 2020.

1.4 Treasury Management is a crucial part of the overall financial management of the Council's finances. The capital prudential indicators consider the affordability and impact of capital expenditure decisions and sets out the Council's overall capital requirement. The treasury indicators consider the effective funding of these decisions.

2.0 Treasury Management Strategy Statement 2020-23

2.1 The Council is currently required to receive and approve the following items each year, which incorporate a variety of policies, estimates and actuals. The strategy is the first and most important and covers

- The capital plans (including prudential indicators)
- The treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators
- An investment strategy (the parameters on how investments are managed)

2.2 A mid year treasury management report and annual treasury report will be submitted to a future meeting of the Policy and Co-ordination Committee.

3.0 Statutory Repayment of Loans Fund Advances

3.1 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.

3.2 In July 2016, the Scottish Government issued Regulations which set out the new statutory arrangements for local authority borrowing and lending. These replaced the statutory arrangements set out in Schedule 3 of the Local Government (Scotland) Act 1975. The Regulations set out the options which are provided to Councils so long as a prudent provision is made each year. The definition of prudence contained in the Regulations is that any repayment of loans fund advances should be reasonably commensurate with the period and pattern of the benefits provided to the community from the capital expenditure. The Proper Officer is given the scope to determine what is prudent for their organisations. Councils were provided with a transitional period of 5 years to implement the new arrangements. Fife Council, in conjunction with Link Asset Services, has reviewed and evaluated the implications of these new Regulations and the revised Loans Fund Policy is included within the Treasury Management Strategy Statement 2020-23

3.3 Fife Council has separate policies for both General Fund advances and Housing Revenue Accounts advances going forward. For General Fund advances, it is considered prudent for Fife Council to reprofile previous years' advances and the Asset Life method, by which loans fund advances will be repaid in line with the expected life of the asset to which the capital expenditure relates, will be used for these and all future General Fund Advances. Fife Council will also consider the use of the Funding/Income Profile method by which loans fund advances will be repaid by reference to an associated income stream, which it is considered appropriate to do so. Fife Council does not consider it prudent to reprofile previous years' Housing Revenue Account advances and all future advances will be repaid using the Asset Life method.

3.4 The reprofiling of the previous year's General Fund loans fund advances will reduce the charge to the Revenue Account in the short to medium-term by spreading the repayment of principal over a longer period resulting in a saving in the Loans Charges budget. As a direct result of the reduced principal repayment, the Capital Financing Requirement going forward will be higher and it will take longer to repay the total advances. These changes have also been included in the budget model.

3.5 It is proposed that this revised policy is implemented from 2019-20 onwards.

4.0 Conclusions

4.1 The treasury activity is crucial to the financial management of the Council. As such, the Council operates within the CIPFA Treasury Code of Practice and the attached Treasury Management Strategy sets out the treasury activity for 2020-23.

4.2 The Loans Fund Policy has been revised in line with the Scottish Government Regulation issued in 2016.

List of Appendices

A. Treasury Management Strategy Statement and Annual Investment Strategy

Background Papers

The following papers were relied on in the preparation of this report in terms of the Local Government (Scotland) Act, 1973:

1. Link Asset Services, Treasury solutions, Interest Rate Forecast – February 2020
2. Treasury Management Strategy Statement 2019-22

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Treasury Management Strategy Statement

and Annual Investment Strategy

2020-23

Introduction

Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. One of the main treasury management functions is to ensure this cash flow is adequately planned, with cash being available when it is needed. Cash is borrowed temporarily for periods of less than 1 year and surplus funds are invested in low risk counterparties commensurate with the Council's low risk appetite, providing security and liquidity initially, before considering investment return.

The second main function is the funding of the Council's capital plan. The capital plan provides a guide to the borrowing need of the Council, essentially the longer-term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer-term cash involves arranging long or short-term loans or using longer term cash flow surpluses. On occasion, existing debt may be restructured to meet Council risk or cost objectives, or where it is financially advantageous to do so.

The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity and the ability to meet spending commitments as they fall due, either on day-to-day out-goings or for larger capital projects. The treasury function will manage the balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Cash balances generally result from reserves and balances and it is paramount to ensure adequate security of the sums invested, as a loss of principal would result in a loss to the General Fund Balance.

CIPFA defines treasury management as:

"The management of the local authority's borrowing, 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"

Loans to third parties, commercial investment initiatives or other non-financial investments will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day to day treasury management activities.

Revised reporting is required for the 2020-21 reporting cycle due to revisions of the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity if that is going to be undertaken. Fife Council's capital strategy was approved by the Policy and Co-ordination Committee in September 2018 and at Fife Council in February 2019.

Reporting Requirements

Capital Strategy

The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2020-21, all local authorities prepare an additional report, a Capital Strategy report, which provides the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial stability.

The aim of this Capital Strategy is to ensure that all elected members of the Council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

Treasury Management Reporting

The Council is currently required to receive and approve, as a minimum three main reports each year, which incorporate a variety of policies, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report) – The first, and most important report covers:

- The capital plans (including prudential indicators)
- The treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- An investment strategy (the parameters on how investments are to be managed)

A mid-year treasury management report – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

An annual treasury report – This is a backward-looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to estimates within the strategy.

Scrutiny – The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Policy and Co-ordination Committee.

Reporting Requirements

Treasury Management Strategy for 2020-21

The strategy for 2020-21 covers two main areas:

Capital issues

- the capital plans and the prudential indicators
- the loans fund repayment policy

Treasury management issues

- the current treasury position of the Council
- treasury indicators which limit the treasury risk and activities of the Council
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy

These elements cover the requirements of the Local Government in Scotland Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and Scottish Government Investment Regulations.

Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management have access to training relevant to their needs and those responsibilities. This especially applies to members responsible for scrutiny. A training session was carried out for members of the Policy and Co-ordination Committee in January 2018 by the Council's treasury adviser, Link Asset Services. Further training is scheduled for 27 April 2020.

Officers attend several events per year in the form of workshops, tutorials and seminars offered by both CIPFA and the Council's treasury adviser, as appropriate, on an ongoing basis.

Treasury Management Consultants

The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors.

Responsibility for treasury management decisions always remains with the Council and will ensure that undue reliance is not placed upon its external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisors.

The Council also recognises there is value in employing external providers of treasury management services to access specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented and subjected to regular review.

Capital Prudential Indicators

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans are financially sustainable.

Capital Expenditure

This prudential indicator is a summary of the Council's agreed capital expenditure plans.

Actual 2018-19 £m	Approved 2019-20 £m		Approved 2020-21 £m	Approved 2021-22 £m	Approved 2022-23 £m
71.874	85.581	General Fund	105.046	90.718	95.692
72.209	63.320	Housing Revenue Account	96.863	109.503	58.345
144.083	148.901		201.909	200.221	154.037

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall in funding results in a borrowing requirement and is known as the Loans Fund Advance.

Actual 2018-19 £m	Approved 2019-20 £m		Approved 2020-21 £m	Approved 2021-22 £m	Approved 2022-23 £m
144.083	148.901	Capital Expenditure	201.909	200.221	154.037
		Less Capital Income			
(32.675)	(38.226)	General Capital Grant	(25.033)	(25.033)	(25.033)
(32.993)	(13.988)	Other Grants	(10.319)	(3.748)	(5.173)
(35.851)	(30.165)	CFCR	(32.852)	(30.947)	(30.387)
(0.772)	(2.863)	Developers Contributions	(1.685)	(5.080)	(10.935)
0.000	0.000	Loan Repayments	0.000	(4.423)	(7.566)
2.122	0.000	Capital Grant Unapplied	(2.158)	0.000	0.000
(3.778)	(6.585)	Capital Receipts	(6.540)	(3.341)	(3.949)
2.865	0.000	Receipts Set Aside	1.300	1.370	0.000
43.001	57.074	Loans Fund Advance	124.622	129.018	70.994

Capital Prudential Indicators 2020-21 to 2022-23

Capital Financing Requirement
(Council's borrowing need)

This second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic 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 borrowing need. Any capital expenditure above which has not immediately been paid for, will increase the CFR.

The CFR will not increase indefinitely, as prudent annual repayments from revenue need to be made which reflect the useful life of capital assets financed by borrowing.

The CFR includes any other long-term liabilities (e.g. PPP/HUB schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the PPP/HUB lease provider and so the Council is not required to separately borrow for these schemes.

The CFR projections are shown below:

Actual 2018-19 £m	Approved 2019-20 £m		Approved 2020-21 £m	Approved 2021-22 £m	Approved 2022-23 £m
802.908	767.291	General Fund	823.221	843.419	856.601
312.452	371.095	Housing Revenue Account	383.319	446.333	455.697
1,115.360	**1,138.386**		**1,206.540**	**1,289.752**	**1,312.298**

Statutory Repayment of Loans Fund Advances

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.

In July 2016 the Scottish Government issued Regulations which set out the new statutory arrangements for local authority borrowing and lending. These replaced the statutory arrangements set out in Schedule 3 of the Local Government (Scotland) Act 1975.

The Regulations set out the options which are provided to Councils so long as a prudent provision is made each year. The definition of prudence contained within the regulations is that any repayment of loans fund advances should be reasonably commensurate with the period and pattern of the benefits provided to the community from the capital expenditure. The proper officer is given the scope to determine what is prudent for their organisations. The Council undertook a review of its loans fund policy during financial year 2019-20 and this was amended in line with the 2016 Regulations and the concept of prudence.

Capital Prudential Indicators 2020-21 to 2022-23

Fife Council Policy

Fife Council will maintain separate policies for General Fund loans fund advances and Housing Revenue Account loans fund advances

General Fund Loans Fund Advances

The 2016 Regulations allow the reprofiling of previous years' loans fund advances should it be considered prudent to do so.

It is considered prudent for Fife Council has opted to take up this option for previous years' General Fund advances and opted to use the Asset Life Method, by which loans fund advances will be repaid in line with the expected life of the asset to which the capital expenditure relates, for both these and future loans fund advances. It is also appropriate for Fife Council has also opted to use the Funding/Income Profile Method, by which loans fund advances will be repaid in line with an associated income stream, where it is considered appropriate to do so.

Housing Revenue Loans Fund Advances

It is not considered prudent for Fife Council to reprofile previous loans fund advances made from the Housing Revenue Account. Future advances will be repaid using the Asset Life Method.

The annuity method will continue to be applied to all loans fund advances. Under regulation, the Council can review and re-assess the annuity rate to ensure it is a prudent application. The annuity rate applied to the loans fund repayments has been reviewed and has been set at 4.00%.

The Capital Investment Plan is funded from a variety of sources (e.g. Capital Grants, Capital receipts etc), with the remainder funded from borrowing. The Council does not borrow for specific projects for either the General Fund or the Housing Revenue Account, with decisions on which projects are funded from the loans fund on an annual basis being at the discretion of the Head of Finance, with overall financial sustainability being considered.

Capital Prudential Indicators 2020-21 to 2022-23

The loans fund balances based on the current Capital Investment Plan are estimated to be:

General Fund	Opening Balance £m	Advances £m	Repayments £m	Closing Balance £m
2020-21	634.942	16.120	(23.983)	627.079
Years 2 – 6	627.079	230.670	(118.598)	739.151
Years 6 - 11	739.151	67.021	(103.619)	702.553
Years 12 -16	702.553	0.000	(110.604)	591.949
Years 17 -21	591.949	0.000	(125.858)	466.091
Years 22 - 26	466.091	0.000	(132.491)	333.600
Years 27 -31	333.600	0.000	(130.824)	202.776
Years 32 – 36	202.776	0.000	(97.931)	104.845
Years 37 - 41	104.845	0.000	(67.902)	36.943
Years 42 – 46	36.943	0.000	(33.578)	3.365
Years 47 – 51	3.365	0.000	(2.763)	0.602
Years 52 -56	0.602	0.000	(0.602)	0.000

HRA	Opening Balance £m	Advances £m	Repayments £m	Closing Balance £m
2020-21	340.131	38.374	(13.151)	363.354
Years 2 – 6	363.354	121.065	(93.239)	393.180
Years 6 - 11	393.180	20.984	(107.977)	306.187
Years 12 -16	306.187	0.000	(94.488)	211.699
Years 17 -21	211.699	0.000	(70.267)	141.432
Years 22 - 26	141.432	0.000	(64.406)	77.026
Years 27 -31	77.026	0.000	(37.875)	39.151
Years 32 – 36	39.151	0.000	(32.727)	6.424
Years 37 - 41	6.424	0.000	(6.424)	0.000

Capital Prudential Indicators 2020-21 to 2022-23

The regulations require that a prior year comparator is included therefore the estimated loans fund balances last financial year were anticipated to be:

General Fund	Opening Balance £m	Advances £m	Repayments £m	Closing Balance £m
2019-20	645.106	14.623	(27.601)	632.128
Years 2 – 6	632.128	178.599	(150.710)	660.017
Years 6 - 11	660.017	74.637	(154.243)	580.411
Years 12 -16	580.411	0.000	(146.806)	433.605
Years 17 -21	433.605	0.000	(151.295)	282.310
Years 22 - 26	282.310	0.000	(126.194)	156.116
Years 27 -31	156.116	0.000	(78.177)	77.939
Years 32 – 36	77.939	0.000	(54.889)	23.050
Years 37 - 41	23.050	0.000	(14.317)	8.733
Years 42 – 46	8.733	0.000	(4.768)	3.965
Years 47 – 51	3.965	0.000	(2.744)	1.221
Years 52 -56	1.221	0.000	(1.083)	0.138
Years 56-61	0.138	0.000	(0.138)	0.000

HRA	Opening Balance £m	Advances £m	Repayments £m	Closing Balance £m
2019-20	323.248	28.512	(11.629)	340.131
Years 2 – 6	340.131	156.808	(83.278)	413.661
Years 6 - 11	413.661	213.675	(125.112)	502.224
Years 12 -16	502.224	0.000	(138.237)	363.986
Years 17 -21	363.986	0.000	(139.166)	224.820
Years 22 - 26	224.820	0.000	(115.996)	108.824
Years 27 -31	108.824	0.000	(63.699)	45.125
Years 32 – 36	45.125	0.000	(32.530)	12.595
Years 37 - 41	12.595	0.000	(12.595)	0.000

Treasury Indicators

Treasury Indicators: limits to borrowing activity

The key Treasury Indicators which are part of the Prudential Code are:

The operational boundary

This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on levels of actual debt and the ability to fund under-borrowing from other cash resources.

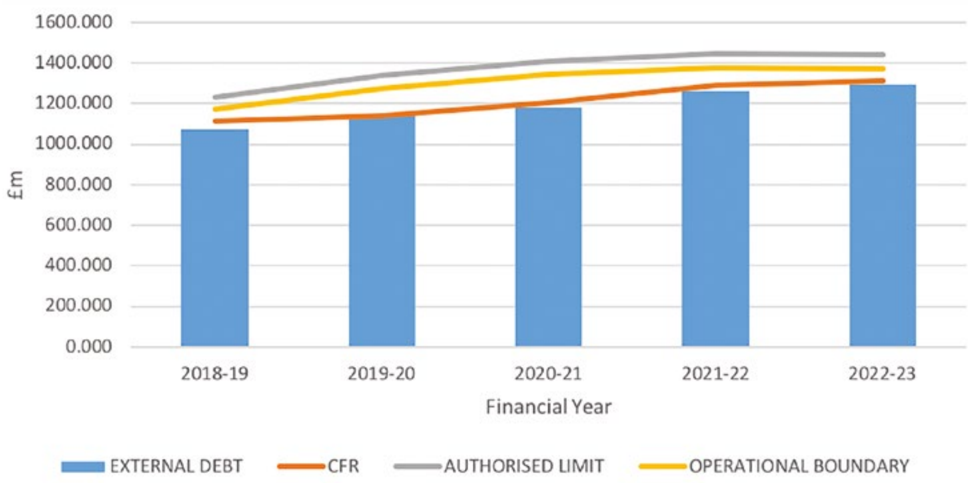
The authorised limit for external debt

This is a key prudential indicator that represents a control on the maximum level of borrowing. This is a limit beyond which external debt is prohibited, and this needs to be set or revised by the full Council. It reflects the level of external debt beyond which, while not desired, could be afforded in the short-term, but is not sustainable in the longer term.

The authorised limits for external debt for the current and two subsequent years are the legislative limits determined under Regulation 6(1) of the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016.

Actual 2018-19 £m	Approved 2019-20 £m		Approved 2020-21 £m	Approved 2021-22 £m	Approved 2022-23 £m
1,071.100	1,141.208	External Debt	1,178.759	1,262.347	1,294.717
1,171.352	1,275.827	Operational Boundary	1.344.084	1.378.540	1.371.752
1,229.920	1,339.618	Authorised Limit	1.411.288	1.447.467	1.440.339

The graph below shows the External Debt to the CFR, Operational Boundary and Authorised Limit.



Treasury Indicators

Treasury Indicators: investment

The key Investment Treasury Indicators which are part of the Treasury Management Code are:

- Upper limits on fixed and variable interest exposures
- Upper and lower limits to the maturity structure of borrowing
- Upper limits to the total of principal sums invested longer than 364 days

Upper limits on fixed and variable interest exposures

The Council's loan portfolio consists of fixed and variable rate debt, plus it has both fixed or variable rate investments. The Code requires limits to be set that manage risk and reduce the impact of adverse movement in interest rates, primarily on variable rate loans. At 31 January 2020, the Council had 32.08% of its total debt in what is termed a "variable structure". The variable nature of the structure of the Council's loans has been managed in the lenders' contracts. These types of contracts are termed LOBO contracts, i.e. Lender Option Borrower Option contracts. The contracts allow the lender to apply to the Council for change in interest rate, after an initial fixed period of several years, to be considered on specific dates. If the Council does not wish to accept the change in interest rates, it can repay the loan in full without penalty. The timing of the opportunity for the lender to change the rate is controlled to limit the risk to the Council and is written into the loan contract. Only on certain anniversaries of the loan issuance can the rate be changed.

Most LOBO loans in the current portfolio are on a 6-month rollover on a variety of dates. Whilst there is an option to vary the interest rate, in practice this rarely happens, and current loans are likely to remain at current interest rates for the foreseeable future, so the risk of interest rate changes is low.

The treasury indicator is detailed in the table below, and previously agreed, as part of the Prudential Indicators

Limits on Interest Rate Exposure (as a % of net debt)	Approved 2020-21	Approved 2021-22	Approved 2022-23
Fixed interest payable / receivable	100%	100%	100%
Variable interest payable / receivable	75%	75%	75%

It is anticipated that the Council's loan portfolio for the next 3 financial years will be exposed to interest rate changes on current debt (as at 31 January 2020) as follows:

External Interest Due	2020-21		2021-22		2022-23	
	£m	%	£m	%	£m	%
Fixed rate loan debt	25.188	66.39	19.217	60.12	18.168	58.76
Variable rate loan debt	12.749	33.61	12.749	39.88	12.749	41.24
Total	37.937		31.966		30.917	

Treasury Indicators

Upper and lower limits to the maturity structure of borrowing

These gross upper and lower limits are set to limit the Council's exposure to large fixed rate sums falling due for refinancing at the same time.

According to the Code, "the maturity of borrowing should be determined by reference to the earliest date on which the lender can require payment. If the lender has the right to increase the interest rate payable such as in a LOBO loan, this should be considered a right to require repayment".

The amount of debt maturing each year is managed by a variety of rollover dates. Members at the Council meeting on 27 February 2020 agreed the Upper and Lower Limits below and, in practice, we have an agreed additional Upper Limit, using the maturity date for LOBO loans of 15%. This is adopted on the basis of continuation of prudent treasury management practice.

	Lower Limit	Upper Limit
Under 12 months	0%	50%
12 months to 2-year period	0%	50%
2 years to 5-year period	0%	50%
5 years to 10-year period	0%	50%
10 years and above	0%	100%

Upper limit to the total of principal sums invested longer than 364 days

It is expected the Council is unlikely to have extended periods when it will have surplus funds due to cash flow. On this basis, the limit on sums to be invested longer than 364 days will remain zero.

Borrowing

The capital expenditure plans provide details of the service activity of the Council. The treasury management function ensures the Council's cash is organised in accordance with the relevant professional codes, so enough cash is available to meet service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current projected debt positions and the annual investment strategy, the current and projected debt positions and the annual investment strategy.

Current Portfolio Position

The Council's treasury portfolio position at 31 March 2019, with forward projections, are summarised below.

Actual 2018-19 £m	Approved 2019-20 £m	Long Term External Debt	Approved 2020-21 £m	Approved 2021-22 £m	Approved 2022-23 £m
965.714	1,046.810	External Borrowing	1,085.714	1,175.714	1,213.714
105.386	94.397	Other Long-Term Liabilities	93.045	86.633	81.003
1,071.100	1,141.208	External Debt	1,178.759	1,262.347	1,294.717
(50.310)	(30.000)	Investments	(30.000)	(30.000)	(30.000)
1,020.790	1,111.208	Net External Debt	1,148.759	1,132.347	1,264.717

The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement – CFR), highlighting any over or under borrowing

Actual 2018-19 £m	Approved 2019-20 £m	Long Term External Debt	Approved 2020-21 £m	Approved 2021-22 £m	Approved 2022-23 £m
1,071.100	1,141.208	External Debt	1,178.759	1,262.347	1,294.717
1,115.360	1,138.386	CFR	1,206.540	1.289.752	1,312.298
(44.260)	2.822	(Under)/over borrowing	(27.781)	(27.404)	(17.582)

Within the range of prudential indicators, there are several key indicators to ensure the Council operates its activities within well-defined limits. One of these indicators puts limits on the Council's borrowing activity. The Council must ensure that its external debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimate of any additional CFR for the next three years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative purposes.

Borrowing

Prospects for Interest Rates

Views on interest rates are crucial to the portfolio strategy for the coming year. Appendix A to this strategy report includes an economic commentary from the Council's treasury adviser, Link Asset Services, and includes the latest central forecast of short and long term borrowing rates as produced by Link Asset Services in February 2020.

Borrowing Strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with external debt, as cash supporting the Council's reserves, balances and cash flow i.e working capital, has been used as a temporary measure. This strategy is prudent as investment returns are low and couterparty risk is still an issue to be considered.

Against this background and the risks within the economic forecast, caution will be adopted within the 2020-21 treasury function. The Executive Director of Finance and Corporate Services will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

At 31 January 2020, the Council's debt portfolio is split in favour of the Public Works Loan Board (PWLB) rather than market lenders and both sources will be considered for future long and short-term loans to meet both capital and revenue requirements. In the current financial year, up to 31 January 2020, two long-term loans (£30m and £20m) have been arranged for periods longer than 364 days, up to 41 years. The loans have been borrowed from the PWLB at 2.40% and 2.19%, maturing in November 2040 and November 2059 respectively. With interest rates currently so low, the strategy previously reported to this committee of continuing to meet any cashflow shortfalls with temporary borrowings or loans for periods where rates are historically low, taking account of our current maturity profile, is still considered prudent.

Based on the interest rate forecast in Appendix A, it is likely that short-term borrowings during 2020-21 will be at interest rates between 0.50% and 1.50%. After consideration of the interest rate estimates and the current debt maturity profile, it is expected that long-term loans will be taken at interest rates of approximately 2.0% to 4.0%.

Borrowing

Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the scrutiny of such funds. However, the following self-imposed constraint will remain on borrowing in advance:

- It is limited to no more than the current financial year's requirement, plus 50% of the estimated requirement for the subsequent two years.

The Net Borrowing Requirement, for 2020-21 is £75.795m taking account of planned capital expenditure, maturing debt and estimated redemption from services and is detailed below:

Estimated Borrowing Requirement 2020-21	£m
General Fund Capital to be funded from borrowing	59.275
HRA Capital to be funded from borrowing	65.347
Loans Fund Advance	124.622
Estimated Redemption of Loans fund debt in year	(38.041)
Estimated debt redemption for other long-term liabilities (PPP)	(6.125)
Capital Financing Requirement (CFR)	80.456
Borrowing required to replace Maturing Long Term Debt	23.750
Net Borrowing Requirement	104.206

This borrowing may be taken at any time during the financial year, after due consideration is given to the prevailing costs of borrowing and available forecasts of interest rates. The requirement for the borrowing will also be reviewed at that time.

Debt Rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur this year. However, if opportunities do arise, any savings will be considered in light of the current treasury position and the size and cost of debt repayment (premiums incurred)

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings
- helping to fulfil the treasury strategy
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility)

All rescheduling will be reported to the Policy and Co-ordination Committee at the earliest meeting following its action.

Annual Investment Strategy

Investment Policy

The Council's investment policy implements the requirements of the Local Government Investments (Scotland) Regulations 2010, (and accompanying Finance Circular 5/2010), and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 (the CIPFA TM Code).

The above regulations and guidance place a high priority on the management of risk. The Council's investment priorities will be firstly security i.e. safeguarding the re-payment of the principal and interest on time, secondly liquidity and the third objective, and third in order of importance, investment return. The Council has one over-riding risk consideration - that of counterparty security risk.

Following a recent tender process, the Royal Bank of Scotland (RBS) were the successful bidder and remain our current banking providers. It is the view of the Executive Director of Finance and Corporate Services that RBS is as secure as any other institution on our lending list. This means that on an overnight basis we may continue to utilise RBS for depositing balances of up to £10.000m.

The Council is generally in a borrowing position, although it does have daily cash flow surpluses from time to time. It is the intention to continue to deposit surpluses in AAA rated money market funds or lend any temporary balances to parties meeting counterparty criteria within approved limits for limited periods in the form of term deposits. However, all activity will be within the constraints of Investment Regulations and the Council's Treasury Management Policy.

Other Investments

In general, no loans to third parties are given, however, from time to time, situations arise which require individual consideration, and these will be reported to Committee as appropriate.

The Council is party to two Employment Land joint ventures with Scottish Enterprise valued at £4.528m. Any further investments in the form of shares would be subject to Committee approval.

Within the category of permitted investment, is Lending for Investment in Housing. As part of this investment category, National Housing Trust (NHT) projects were agreed in Crail and Rosyth. The total loans outstanding for these projects is £16.247m.

Appendix A

Link Asset Services

Interest Rate Forecast – 4 February 2020

The Council has appointed Link Asset Services as its treasury adviser and part of its service is to assist the Council to formulate a view on interest rates. The following table gives Link Asset Services' central view:

Link Asset Services Interest Rate View	Dec 20	Mar 20	Jun 20	Sep 20	Dec 20	Mar 21	Jun 21	Sep 21	Dec 21	Mar 22	Jun 22	Sep 22	Dec 22	Mar 23
Bank Rate View	0.75%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.25%
3 Month LIBID	0.70%	0.70%	0.70%	0.80%	0.90%	1.00%	1.00%	1.00%	1.10%	1.20%	1.30%	1.30%	1.30%	1.30%
6 Month LIBID	0.80%	0.80%	0.80%	0.90%	1.00%	1.10%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.50%	1.50%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.20%	1.30%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.70%	1.70%
5yr PWLB Rate	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.20%	3.20%
10yr PWLB Rate	2.60%	2.70%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%
25yr PWLB Rate	3.20%	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%
50yr PWLB Rate	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%

Link Asset Services

Link Asset Services – Commentary – February 2020

The above forecasts are based on an assumption that there is an agreed deal on Brexit, including agreement on the terms of trade between the UK and EU, at some point in time. The result of the general election has removed much uncertainty around this major assumption. However, it does not remove uncertainty around whether agreement can be reached with the EU on a trade deal within the short time to December 2020, as the prime minister has pledged.

It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2020 due to the ongoing uncertainty over Brexit and the outcome of the general election. In its meeting on 7 November, the MPC became more dovish due to increased concerns over the outlook for the domestic economy if Brexit uncertainties were to become more entrenched, and for weak global economic growth: if those uncertainties were to materialise, the MPC were likely to cut Bank Rate. However, if they were both to dissipate, then rates would need to rise at a "gradual pace and to a limited extent". Brexit uncertainty had a dampening effect on UK GDP growth in 2019, especially around mid-year. There is still some residual risk that the MPC could cut Bank Rate as the UK economy is still likely to only grow weakly in 2020 due to continuing uncertainty over whether there could effectively be a no deal Brexit in December 2020 if agreement on a trade deal is not reached with the EU. Until that major uncertainty is removed, or the period for agreeing a deal is extended, it is unlikely that the MPC would raise Bank Rate.

Bond yields / PWLB rates.

There has been much speculation during 2019 that the bond market has gone into a bubble, as evidenced by high bond prices and remarkably low yields. However, given the context that heightened expectations that the US was heading for a recession in 2020, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated, as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

Link Asset Services

During the first half of 2019-20 to 30 September, gilt yields plunged and caused a near halving of longer term PWLB rates to completely unprecedented historic low levels. There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but also in the UK due to a correlation between US treasuries and UK gilts; at various times this correlation has been strong but at other times weak. However, forecasting the timing of this, and how strong the correlation is likely to be, is very difficult with any degree of confidence. Changes in UK Bank Rate will also impact on gilt yields.

One potential danger that may be lurking in investor minds is that Japan has become mired in a twenty-year bog of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that this condition might become contagious to other western economies.

Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt-fuelled boom that now makes it harder for central banks to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

In addition, PWLB rates are subject to ad hoc decisions by H.M. Treasury to change the margin over gilt yields charged in PWLB rates: such changes could be up or down. It is not clear that if gilt yields were to rise back up again by over 100bps within the next year or so, whether H M Treasury would remove the extra 100 bps margin implemented on 9.10.19.

Economic and interest rate forecasting remains difficult with so many influences weighing on UK gilt yields and PWLB rates. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

Link Asset Services

Investment and borrowing rates

Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress was made with an agreed Brexit, then there is upside potential for earnings.

Borrowing interest rates were on a major falling trend during the first half of 2019-20 but then jumped up by 100 bps on 9.10.19. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.

While this authority will not be able to avoid borrowing to finance new capital expenditure and to replace maturing debt there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

Fife Council Treasury Management Strategy Statement and Annual Invesment Strategy 2020-23

Alternative Formats

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