**REPORT TO:** East Lothian Council

**MEETING DATE:** 24 February 2015

**BY:** Depute Chief Executive (Resources and People Services)

**SUBJECT:** Treasury Management Strategy 2015/16 to 2017/18

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## 1 PURPOSE

1.1 To seek the approval of the Council of the Treasury Management and Investment Strategies for 2015/16 to 2017/18.

## 2 RECOMMENDATIONS

2.1 The Council is recommended to :

i. Note the Treasury Management Strategy detailed in section 3.4.

ii. Note the Investment Strategy detailed in section 3.19.

iii. Approve authorised limits for external debt as detailed in section 3.13.

iv. Approve operational boundaries for external debt as detailed in section 3.15.

v. Approve the delegation of authority to the Head of Council Resources to effect movement between external borrowing and other long-term liabilities as detailed in section 3.16.

vi. Approve the detailed Treasury Management Strategy Statement which has been lodged in the Members Library (Ref: 19/15, February 2015 Bulletin).

## 3 BACKGROUND

3.1 It is a statutory requirement, under Section 93 of the Local Government Finance Act 1992, that the Council produces a balanced budget. In particular, a local authority must calculate its budget for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby related charges to the revenue accounts from:

- Increased interest charges caused by increased borrowing to finance additional capital expenditure, and

- Increased running costs arising from new capital projects

are limited to a level that is affordable within the projected income of the Council for the foreseeable future.

3.2 The Treasury Management Code of Practice, updated by CIPFA in 2011, requires the Council to approve a Treasury Management Strategy and an Investment Strategy in advance of each financial year.

3.3 A detailed document covering both the Treasury Management and Investment Strategies for 2015/16 to 2017/18 has been placed in the Members' Library (Ref: 19/15, February 2015 Bulletin). This report highlights the key points from those strategies. The figures are compatible with those used in setting the Council Tax and HRA rents on 10 February 2015.

**Treasury Management Strategy**

3.4 Actual capital expenditure incurred in 2013/14 together with the estimates of total gross capital expenditure to be incurred for 2014/15 and future years are detailed below in Table 1.

**Table 1: Capital Expenditure**

| | 2013/14 £'000 actual | 2014/15 £'000 estimate | 2015/16 £'000 estimate | 2016/17 £'000 estimate | 2017/18 £'000 estimate |
|---|---|---|---|---|---|
| General Services | 24,825 | 21,510 | 27,380 | 20,750 | 23,178 |
| HRA | 20,805 | 22,184 | 25,450 | 17,906 | 26,538 |
| **TOTAL** | **45,630** | **43,694** | **52,830** | **38,656** | **49,716** |

3.5 Not all of this spending will be funded by borrowing with a significant element being funded by grant, receipts and other capital income contributions. Table 2 overleaf details the actual and planned capital expenditure over the period alongside the sources of funding.

| Table 2: Net Financing Need for the Year | 2013/14 £'000 actual | 2014/15 £'000 estimate | 2015/16 £'000 estimate | 2016/17 £'000 estimate | 2017/18 £'000 estimate |
|---|---|---|---|---|---|
| General Services Gross Capital Spend | 24,825 | 21,510 | 27,380 | 20,750 | 23,178 |
| HRA Gross Capital Spend | 20,805 | 22,184 | 25,450 | 17,906 | 26,538 |
| **Sub-total (from Table 1)** | **45,630** | **43,694** | **52,830** | **38,656** | **49,716** |
| **Financed by;** | | | | | |
| Capital grants | (12,888) | (18,592) | (15,077) | (10,650) | (10,745) |
| Capital receipts/contributions | (3,036) | (5,156) | (4,043) | (5,713) | (4,720) |
| Capital reserves | - | - | - | - | - |
| Revenue Contributions | (1,701) | (3,221) | (1,253) | (1,232) | (1,433) |
| **Sub-total** | **(17,625)** | **(26,969)** | **(20,373)** | **(17,595)** | **(16,898)** |
| | | | | | |
| **Net Financing Need for the Year** | **28,005** | **16,725** | **32,457** | **21,061** | **32,818** |

3.6 Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2013/14 are listed in Table 3 below:

| Table 3: Ratio of financing costs to revenue stream | 2013/14 % actual | 2014/15 % estimate | 2015/16 % estimate | 2016/17 % estimate | 2017/18 % estimate |
|---|---|---|---|---|---|
| General Services | 8.34% | 8.58% | 8.62% | 8.84% | 9.03% |
| HRA | 26.98% | 34.14% | 34.56% | 36.52% | 36.73% |

3.7 The relatively gradual increase in the General Services ratio reflects the standstill in corporate income against a background of continuing, albeit lesser capital spend. The increase in the HRA ratio reflects the increased levels of planned investment in both new affordable housing and modernisation of existing stock, which is mainly financed through borrowing. This borrowing has to be repaid with interest and this leads to increased financing costs.

3.8 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The Council does not associate borrowing with particular items or types of expenditure. The authority has an integrated treasury management strategy and has adopted the CIPFA Code of Treasury Management in the Public Services. The Council has at any point in time a number of cash flows both positive and negative. In day-to-day cash management, no distinction is made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the Council and not simply those arising from capital spending. However, other than to manage short-term cash flows, the Council is not allowed to borrow for revenue purposes.

3.9 Estimates of the end of year capital financing requirement (CFR) for the Council for the current and future years, and the actual levels of CFR at 31 March 2014 are detailed in Table 4 below;

**Table 4: Capital Financing Requirement (CFR)**

| | 2013/14 £'000 actual | 2014/15 £'000 estimate | 2015/16 £'000 estimate | 2016/17 £'000 estimate | 2017/18 £'000 estimate |
|---|---|---|---|---|---|
| Total CFR at start of year | 412,027 | 427,293 | 430,017 | 448,022 | 453,444 |
| Movement in CFR | 15,266 | 2,724 | 18,005 | 5,422 | 16,168 |
| **Total CFR at end of the year** | **427,293** | **430,017** | **448,022** | **453,444** | **469,612** |
| **Movement in CFR represented by** | | | | | |
| Net Financing Need for the year (from Table 2) | 28,005 | 16,725 | 32,457 | 21,061 | 32,818 |
| Less: Scheduled Debt Amortisation | (12,739) | (14,001) | (14,452) | (15,639) | (16,650) |
| **Movement in CFR** | **15,266** | **2,724** | **18,005** | **5,422** | **16,168** |

3.10 The importance of the CFR lies in the way it measures the need to borrow for a capital purpose excluding the effect of revenue cash flows.

3.11 The key indicator of prudence is that external borrowing should not exceed the CFR for the preceding year plus additional CFR in the current and two following years. At the close of the 2013/14 financial year, the Council was well within this indicator, as the relevant CFR was £427.293 million and external borrowing was £391.127 million.

3.12 The Council's treasury portfolio position at 31 March 2014, with forward projections are summarised in Table 5 below. The table shows the actual external debt (the treasury management operations) against the underlying capital borrowing need (the Capital Financing Requirement – CFR) highlighting any over or under borrowing.

| Table 5: Actual Debt and the Capital Financing Requirement (CFR) | | | | | |
|---|---|---|---|---|---|
| | 2013/14 £'000 estimate | 2014/15 £'000 estimate | 2015/16 £'000 estimate | 2016/17 £'000 estimate | 2017/18 £'000 estimate |
| Total External debt at start of year | 367,894 | 391,127 | 410,216 | 436,825 | 444,399 |
| Expected/Actual change in debt | 24,559 | 20,382 | 27,795 | 8,760 | 15,514 |
| Other long term liabilities (OLTL) | 46,085 | 44,759 | 43,466 | 42,280 | 41,094 |
| Expected/Actual change OLTL | (1,326) | (1,293) | (1,186) | (1,186) | (1,186) |
| **Actual gross debt at 31 March** | **391,127** | **410,216** | **436,825** | **444,399** | **458,727** |
| **The Capital Financing Requirement (from Table 4)** | **427,293** | **430,017** | **448,022** | **453,444** | **469,612** |
| **(Under)/Over borrowing** | **(36,166)** | **(19,801)** | **(11,197)** | **(9,045)** | **(10,885)** |

3.13 The Council is recommended to approve the following authorised limits for its gross external debt for the next three years. These limits separately identify borrowing from other long-term liabilities such as finance leases.

| Table 6: Authorised Limit for External Debt | | | | |
|---|---|---|---|---|
| | 2014/15 £'000 estimate | 2015/16 £'000 estimate | 2016/17 £'000 estimate | 2017/18 £'000 estimate |
| Borrowing | 414,000 | 433,000 | 440,000 | 457,000 |
| Other long term liabilities | 56,000 | 55,000 | 54,000 | 53,000 |
| **Total** | **470,000** | **488,000** | **494,000** | **510,000** |

3.14 These authorised limits are consistent with the Council’s current commitments, existing plans and the budget proposals for capital expenditure and financing approved on 10 February 2015, and with the approved treasury management policy. The limits are based on the estimate of the most likely, prudent but not worst-case scenario with, in addition, sufficient headroom over and above this to allow for the operational management of unusual cash flows, such as debt restructuring.

3.15 The Council is also asked to approve in Table 7 the operational boundaries for gross external debt. These are based on the authorised limits but excluding headroom.

| Table 7: Operational Boundary for External Debt | | | | |
|---|---|---|---|---|
| | **2014/15 £'000 estimate** | **2015/16 £'000 estimate** | **2016/17 £'000 estimate** | **2017/18 £'000 estimate** |
| Borrowing | 383,928 | 403,259 | 409,648 | 427,002 |
| Other long term liabilities | 46,089 | 44,763 | 43,796 | 42,610 |
| **Total** | **430,017** | **448,022** | **453,444** | **469,612** |

3.16 The Council has delegated authority to the Head of Council Resources to effect movement between borrowing and long-term liabilities within the total authorised limits and operational boundaries approved. Any such movement would be reported to Cabinet via the Members' Library as part of Treasury Management update reports.

3.17 Within the limits set by the indicators above, the Council will make capital investment decisions in accordance with the following fundamental principles of the Prudential Code:

- Service objectives e.g. achieving the Council Plan objectives
- Stewardship of assets e.g. asset management planning
- Affordability e.g. implications for Council Tax
- Value for money e.g. option appraisal
- Prudence and sustainability e.g. implications for external borrowing
- Practicality e.g. is the investment proposal practical given other competing pressures on the service involved

3.18 A key measure of affordability is the incremental impact of capital investment decisions on the Council Tax and Council House rents. The impacts of the expenditure plans are set out in Table 8:

| Table 8: Incremental impact of capital investment decisions | | | |
|---|---|---|---|
| | **2015/16 £ p estimate** | **2016/17 £ p estimate** | **2017/18 £ p estimate** |
| Increase in Council Tax (band D) per annum | 8.16 | 12.38 | 11.52 |
| Increase in average housing rent per week | 1.21 | 2.33 | 1.35 |

**Investment Strategy**

3.19 The Council's Investment Strategy for 2015-18 has been prepared in accordance with the Local Government Investments (Scotland) Regulations 2010 and the CIPFA Treasury Management Code.

3.20 The Investment Strategy details the approach which the Council will take to minimise the risk to investments and lists the investments which the Council will be permitted to use.

3.21 Common Good and Charitable Trust funds are managed on behalf of the Council by an external investment management firm. The strategy details the Council's policy on the investment of these funds.

3.22 The indicator below sets a limit on the total level of investments held for longer than 364 days.

| **Maximum principal sums invested > 364 days** | | | |
|---|---|---|---|
| **£m** | **2014/15** | **2015/16** | **2016/17** |
| Principal sums invested > 364 days | £m<br>30 | £m<br>30 | £m<br>30 |

## 4 POLICY IMPLICATIONS

4.1 Implementation of Council policy and supporting plans will require capital expenditure. The policy effect of a proposed capital expenditure will be assessed as part of the project appraisal.

4.2 The limited resources available form an important constraint on the development of policy, which requires to be managed through the development of a sustainable Council Plan associated with a supporting Corporate Asset Management Plan.

## 5 EQUALITIES IMPACT ASSESSMENT

5.1 This report is not applicable to the wellbeing of equalities groups and an Equalities Impact Assessment is not required.

## 6 RESOURCE IMPLICATIONS

6.1 Financial – these strategies are interwoven with the revenue and capital budgets. The expenditure and debt limits are consistent with the revenue budgets approved by the Council on 10 February 2015.

6.2 Personnel - none directly from this report although there may be implications arising from capital investment decisions.

6.3 Other – capital investment choices made have a major impact on the property, equipment and IT resources available for the delivery of services.

## 7 BACKGROUND PAPERS

7.1 CIPFA (2011) – "Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes"

7.2 CIPFA (2011) – "The Prudential Code for Capital Finance in Local Authorities"

7.3 The Local Government (Scotland) Regulations 2010

7.4 Capital Investment & Treasury Management Strategy 2014/15 to 2016/17

7.5 Treasury Management Strategy Statement and Annual Investment Strategy – Mid Year Review 2014/15

7.6 Council 10 February 2015 – all budget papers


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| **AUTHOR'S NAME** | Jim Lamond |
| **DESIGNATION** | Head of Council Resources |
| **CONTACT INFO** | jlamond@eastlothian.gov.uk |
| **DATE** | 13/02/2015 |