

PERTH AND KINROSS COUNCIL

24 February 2016

TREASURY & INVESTMENT STRATEGY and PRUDENTIAL INDICATORS
2016/17 – 2020/21

Report by the Head of Finance

PURPOSE OF REPORT

This report details the Council's proposed Treasury Strategy and activities and the Investment & Property Strategy for 2016/17, and an update on the Prudential Indicators for the 6 financial years 2016/17 to 2021/22.

1. BACKGROUND / MAIN ISSUES

- 1.1 The Treasury and Investment Strategies detail the expected activities of the treasury function for the relevant financial years. Their submission to the Council is a requirement of the Council's approved TMP6 (*Reporting Requirements & Management Information Arrangements*), and is also a requirement under the CIPFA Code of Practice for Treasury Management. The Investment Strategy also 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 also a requirement of the Local Government Investments (Scotland) Regulations 2010.
- 1.2 In determining the Treasury Strategy, the Council would normally also set new Prudential Indicators. For this year, the Council has deferred setting a new 7-year Composite Capital Budget for 2016/17 to 2022/23 until its meeting on 22 June 2016. This report therefore gives an update on the current Prudential Indicators, and proposes that the new Prudential Indicators are not set until after the new Capital Budget is set in June 2016.
- 1.3 The proposed strategy for the financial years 2016/17 to 2021/22 in respect of the treasury management function covers:
 - The current Treasury position
 - Prospects for interest rates
 - Capital requirements and the borrowing strategy 2016/17 to 2021/22
 - The Investment Strategy 2016/17
 - Investment properties 2016/17
 - Debt rescheduling opportunities
 - The Prudential Code
 - Prudential Indicators 2015/16 to 2020/21

2. THE CURRENT TREASURY POSITION

2.1 In order to put the proposed treasury strategy into context, the Council's treasury position as at 31st January 2016 is shown below:

		<u>PRINCIPAL OUTSTANDING</u> (£million)	<u>AVERAGE RATE</u> (%)
Fixed Rate Funding	• Public Works Loan Board (PWLB)	190.0	4.08
	• Market Bonds	<u>10.6</u>	<u>2.53</u>
		<u>200.6</u>	<u>4.00</u>
Variable Rate	• Market Bonds	38.2	4.67
	• Local Loans	<u>8.1</u>	<u>0.42</u>
		<u>46.3</u>	<u>3.93</u>
TOTAL GROSS DEBT		246.9	3.99
TOTAL SHORT TERM MARKET INVESTMENTS		67.1	0.72
TOTAL NET DEBT		179.8	5.21

2.2 The projected Borrowing Requirement for each of the next six 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 Capital Budgets which is to be funded by new borrowing. The Borrowing Requirement also takes into account maturing debt requiring to be refinanced, less an annual amount amortised (charged) to the Revenue Account (to ensure the total debt on the ongoing programme matches the remaining useful life of the underlying assets).

	<u>2016/17</u>	<u>2017/18</u>	<u>2018/19</u>	<u>2019/20</u>	<u>2020/21</u>	<u>2021/22</u>	<u>Total</u>
Borrowing Requirement	£30.0m	£25.0m	£18.8m	£16.4m	£20.1m	£21.3m	£131.6m

2.3 The above figures are based on the latest Composite Capital Budget for 2015/16 to 2021/22 approved by the Strategic Policy & Resources Committee on 10 February 2016 (report 16/46 refers), and the Housing Revenue Account Investment Programme for 2015/16 to 2020/21 approved by the Housing & Health Committee on 27 January 2016 (report 16/28 refers). The above figures also include an estimate of the annual borrowing requirement carried-forward between years.

3. PROSPECTS FOR INTEREST RATES

3.1 The Council's treasury adviser, Capita Asset Services Ltd, assists the Council in formulating a view on interest rates. Appendix I shows various forecasts of the Bank Rate (or short-term or variable rates) and longer-term fixed interest rates, whilst Appendix II shows the Capita forecast in graphical form.

- 3.2 The period of volatility and low interest rates in the global economy continued throughout the last year. This has included a period of low inflation which has remained at or around 0%, and which is expected to remain at these levels for much of the coming year. UK Government gilt yields have also fallen significantly over the last year as global economic prospects have diminished, most notably in China, and oil prices and inflation have fallen dramatically. This period has also seen growing political concerns, particularly in Russia and Greece. Therefore, investors have increased their holding of gilts as the UK is seen as a “safe haven”, resulting in a reduction in their yield.
- 3.3 The outlook for interest rates, therefore, remains volatile making it difficult to make forecasts with any degree of certainty, particularly in the shorter term. There are considerable risks, particularly relating to Chinese and Eurozone economic activity, and low inflation as a result of falling commodity prices, particularly oil. Meanwhile, the improving economic prospects in the UK and the USA appear to have peaked, adding to the economic uncertainty.
- 3.4 It is currently expected that the Bank Rate will remain at its current low level of 0.5%, with the first increase not now expected until the end of 2016 or early in 2017 at the earliest. The Bank Rate is forecast to only increase gradually over the subsequent few years. Furthermore, the long term average is expected to be around 3%, which is lower than the historic average of around 5%. Longer term rates are also expected to start rising slowly from 2016 and in future years. Shorter and medium term rates are expected to follow the same pattern as longer term rates, although at a lower level than the longer term rates.

4. CAPITAL REQUIREMENTS AND BORROWING STRATEGY

- 4.1 As noted above, the Council is to set a new Composite Capital Budget for the 7 year period to 2022/23 at its meeting on 22 June 2016, therefore, at this stage, this strategy is only concerned with the 6 years to 2021/22. Future interest rate forecasts throughout this period must be considered, particularly when determining the most appropriate timing and maturity structure of new borrowing and when comparing fixed rates and variable rates. The projected new Borrowing Requirement is uneven over the six years, with the main variable being the refinancing requirement for maturing debt in each year. It should also be noted that the 2020/21 and 2021/22 borrowing requirement reflects the assumptions previously made in setting the Composite Capital Budget for these years, with no new borrowing included at this stage, and with only a modest provisional amount of borrowing assumed on the HRA Housing Investment Programme in 2021/22. However, these assumptions may be revised when the next Composite Capital Budget is set by the Council in June 2016.
- 4.2 The previous Treasury Strategy was to continue to undertake borrowing in the current low interest rate environment. This included consideration of borrowing for future needs within the current 6 year programme, particularly given the large levels of debt that reaches maturity and has to be repaid during this period. The previous interest rate forecasts showed that interest

rates were expected to rise steadily over the next three years, therefore borrowing at current historically low rates would have resulted in significant savings in interest charges in future years.

- 4.3 However, the current interest rate forecast indicates that the period of low interest rates is expected to continue throughout most of 2016. Accordingly, only borrowing for current requirements was undertaken in the last year. Therefore, the need for new borrowing will continue in the coming year, together with consideration of future borrowing requirements in advance of rates starting to rise.
- 4.4 Short dated borrowing would be cheaper than longer term borrowing. However, consideration must also be given to the use of longer term borrowing to make longer term savings and reduce the refinancing risk in later years. Effective Treasury Management must therefore consider the longer-term position in order to minimise costs and risks in the Council's portfolio. This strategy will be continuously reviewed, including accelerating further borrowing to meet future requirements within the 6 year period should rates start to increase rapidly. This additional flexibility to borrow in advance of need is permissible where it can be shown to be cost-effective, but must be considered in conjunction with the associated additional risks and low returns of the resultant increase in investments in the short term. Alternatively, current long term borrowing requirements may be delayed if rates stay low, with short term borrowing used to meet immediate short term cashflow requirements, thus avoiding the low returns and additional risks of short term investments.
- 4.5 LOBOs (Lenders Option Borrowers Option) or other appropriate market instruments can offer favourable rates in comparison to the Public Works Loan Board (PWLB), and will be considered and used where appropriate. This will be considered in conjunction with the additional risks associated with LOBOs due to their variable rate nature and their less flexible terms.
- 4.6 Given these risks, together with inherent uncertainties in interest rate projections, this strategy will be closely monitored and reviewed in light of future interest rate movements. This is particularly the case in the coming year, given the current historically low interest rate environment and the Council's future requirements.
- 4.7 It is generally the policy of the Council to be "risk-aware" and, in light of the prevailing economic conditions, the Council will actively seek to manage treasury risks. Interest rate movements will be closely monitored to allow a pragmatic and flexible approach to be taken should circumstances change from those outlined above. Any changes in this approach will be reported to the Council at the next available meeting as part of the Quarterly Treasury Activities and Compliance report.
- 4.8 As with any forecast, the above interest rate expectations are subject to variation, particularly during the current period of economic and political uncertainty and volatility. The main sensitivities of the above forecast are likely to be as follows:

- An unexpected further fall in long term rates which, for example, could occur if economic growth, inflation or oil prices fell further from their current low levels or for a prolonged period, or increased political risks impacting on the global economy materialised. In this scenario, long-term borrowing would be deferred until rates were anticipated to have troughed.
- An unexpected sharp rise in both long and short term rates which could occur if, for example, economic growth increased significantly, or if inflation started to increase rapidly, thus bringing forward increases in the Bank Rate. In this scenario, fixed rate funding would be considered during the year whilst rates are still relatively low, including consideration of future requirements.

4.9 The Prudential Code requires authorities to detail the strategy on gross and net debt where there is a significant difference between them. This would arise where there is a significant level of both investments and borrowing. It is not possible or desirable to have no investments at all, due to the daily variations in the Council's cashflow (which tends to be more positive in the first half of the financial year), or following the borrowing of long term debt (which may be in advance of need due to favourable interest rates). In addition, the level of investments may also increase where there are significant levels of Reserves. The level of investments will be maintained at a level consistent with an acceptable level of risk and subject to short-term variations.

5. INVESTMENT STRATEGY 2016/17

- 5.1 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, including identifying the risks associated with the strategy and the minimum reporting requirements.
- 5.2 It is not proposed to make any changes to the current Permitted Investments of the Council, which 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. It is also not proposed to make any further changes to the limits for these investments or counterparties other than the proposed amendment outlined in the Quarterly Treasury Activity & Compliance report being considered at this meeting. These limits ensure that the Council maintains sufficient liquidity and a spread of investments at all times, whilst the counterparty list is reviewed continuously in light of credit-rating changes and other market information.

- 5.3 Details of how investments are managed are contained in the Treasury Management Practices (TMPs), which include the levels of acceptable risk: the approach to the assessment of counterparties: reporting requirements and detailed treasury management practices. The TMPs also detail various control arrangements, including transactional controls, to ensure compliance with policies and procedures. The TMPs are reviewed at least annually, whilst the treasury policies are reviewed continuously in light of prevailing economic and market conditions. A copy of the Treasury Systems Document, which includes the TMPs, is available on the Councillor's CHIP Sharepoint site.
- 5.4 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. Longer term investments may arise where the Council has significant cash-backed reserves, or following a decision to borrow in advance of need within the determined Capital Financing (borrowing) Requirement. Longer term investments carry greater risk of default by the counterparty, as well as a higher liquidity and market risk of adverse movements in interest rates. Therefore, such investments are limited to £10M and up to a maximum of 3 years, as detailed in the Permitted Investments at Appendix III, and they would only be undertaken after consideration of cashflow and interest rate forecasts to determine the optimum duration. However, given current interest rate forecasts and counterparty limits, it is unlikely that any investments for more than one year will be made during 2016/17. This strategy will be reviewed continuously in light of economic forecasts and market developments.
- 5.5 Whilst the risk of default on investments is perceived to have diminished in recent years, low returns are anticipated to continue throughout the next year. The level of investments held has increased over the last year since the Council resumed borrowing, and it is anticipated that the level of investments will increase further early in the financial year, before falling again in the second half of the year as a result of uneven cashflows over the year. The level of investments is not expected to exceed £60,000,000 during the year, unless further new borrowing is undertaken early in the year or if the profile of the Council's expenditure during the year is later than originally anticipated.
- 5.6 The proposed Permitted Investments allow investments to be made for up to three years. However, as described above, it is not expected that any investments will be made for more than one year during 2016/17. It is anticipated that the majority of investments will be deposits with banks and building societies on instant access or notice terms, or fixed deposits for periods of up to one year. The amount invested in each type of investment cannot readily be predicted, but it is anticipated that the totality of fixed deposit investments will peak at around £50,000,000. Approved Money Market Funds will also be used for short term liquidity or when other counterparty limits are reached. The maximum limit is £10,000,000 per fund and it is anticipated that the actual level of investment in such funds will vary in line with daily fluctuations in the Council's cashflow. These forecast amounts are dependent on several factors, such as changes in cashflow, any long term borrowing,

and market opportunities which may arise. Actual investment activities undertaken will be included in the Quarterly Treasury Activities and Compliance reports submitted to the Council throughout the year.

- 5.7 The Permitted Investments also include loans to third parties, which may be given on preferential terms or interest rates. These may arise for operational reasons, where for example a Service wishes to provide financial support to an organisation. It should also be noted that such loans are determined by Service requirements and will be constrained by virtue of the Service having to meet all costs related to the granting of such loans, including impairments to the recoverable value and any accounting adjustments relating to “soft loans” (ie, loans given on interest free or below market rate terms). All loans to third parties must also be individually approved by the Council.
- 5.8 The Investment Strategy and Activities will be approved and scrutinised by the Council, in line with current Treasury Management arrangements. This will be achieved by the submission of Quarterly Treasury Activity & Compliance reports, which include monitoring of the investment policies. In addition, the Annual Treasury Report to the Council includes retrospective details of the investment strategy adopted, and details compliance and performance against the strategy for that year.
- 5.9 The Common Good Funds operate with only 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 specific approval of the Common Good Committee. It is therefore 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. Accordingly, all Common Good cash and balances will be invested with the Council’s Loans Fund, either as an instant access deposit, fixed term deposit, or as revenue advances attracting Interest on Revenue Balances (IORB). It is not proposed to change the terms under which the Common Good funds place deposits with the Loans Fund.
- 5.10 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. The Common Good’s Property Investment Strategy is included within the Council’s Property Investment Strategy (see Section 6 below).
- 5.11 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 Council funds that are managed by external investment managers, with the exception of Council charity or trust funds, are covered by this strategy, and the investment manager is therefore bound by this Investment Strategy in relation to those funds. However, it is not proposed to use any external investment manager during 2016/17, other than for the Council’s charitable funds.

6. INVESTMENT PROPERTIES 2016/17

- 6.1 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.
- 6.2 The portfolio is expected to generate a gross income of approximately £1,898,000 for 2015/16, with this figure projected to drop slightly to £1,729,000 for 2016/17 and this will be closely monitored in light of the current economic and market conditions.
- 6.3 The Annual Property Investment Strategy 2016/17 is attached in 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.
 - Operational occupation e.g. workshop units occupied by TES/ECS Services.
 - Revenue generation e.g. St Johns Centre head lease
- 6.4 The overall aim of the attached Property Investment Strategy for Perth & Kinross Council is to support the objectives of the “2013/18 Corporate Plan – Securing the Future” and in doing so, it meets the requirements of the Regulations.

7. DEBT RESCHEDULING

- 7.1 The low current interest rate environment together with the current borrowing terms and conditions of the PWLB, where different interest rates are applicable for new borrowing and premature repayments, mean that any early redemption of PWLB loans is unlikely to generate opportunities for savings. This is compounded by the increased margin on new borrowing rates applied by the PWLB, without a corresponding increase in the repayment rates. More significant savings may be achieved using LOBOs, however, such loans offer less long-term flexibility.
- 7.2 The main benefits of undertaking rescheduling would include:
- Interest savings, without exposing the Council to additional risk,
 - Ensuring a better balanced maturity profile and volatility ratio in the portfolio,
 - Assisting the achievement of the desired strategy of reducing the level of investments, as outlined above.
- 7.3 However, for the reasons outlined above, there is unlikely to be any debt rescheduling undertaken during 2016/17.

8. THE PRUDENTIAL CODE

- 8.1 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. However, to improve longer term strategic and forward planning, the Council has operated a seven year Capital Budget.
- 8.2 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. Consequently, the level of Capital Financing Costs strongly influences the size of the ongoing Capital programme. Effective and proactive Treasury Management aims to minimise these capital borrowing costs ("Loan Charges") and their impact on the overall finances of the Council, whilst not exposing the Council to undue risk in the longer term. Adverse movements in interest rates, for example, would directly impact on the level of Capital expenditure which is affordable and sustainable.
- 8.3 The average borrowing costs for all Scottish local authorities are published annually and in recent years the average interest rate payable by this Council (the Loans Fund pooled rate) has consistently been within the three lowest in Scotland. This reflects the Council's prudent and pro-active approach to its borrowing and investment strategy and minimising its borrowing costs.

9. PRUDENTIAL INDICATORS 2016/17 to 2020/21

- 9.1 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 be set annually and relate to, and be consistent with, the Council's approved Capital Budget and Treasury Management Strategy. It is proposed that no new Prudential Indicators are set as part of this report.
- 9.2 At the special Council meeting on 11 February 2016, the Council did not set a new Composite Capital Budget. Accordingly, the Composite Capital Budget Monitoring report considered by the Strategic Policy & Resources Committee on 10 February 2016 (report 16/46 refers) includes budgets up to 2021/22 and remains the last approved budget. However, for 2020/21 and 2021/22 no new borrowing has been included, and this will be subject to further consideration by the Council in June 2016. Furthermore, the Housing & Health Committee at its meeting on 27 January 2016 (report 16/28 refers) set a revised Housing Investment Programme for the years to 2020/21, which is included in report 16/46 approved by the Strategic Policy & Resources Committee.
- 9.3 The Quarterly Treasury Activity and Compliance report is a separate report on the agenda for this meeting, and includes the monitoring of the Prudential Indicators for the years up to 2020/21. Therefore, for this year, it is proposed that no new Prudential Indicators are formulated until after a revised Composite Capital Budget is approved in June 2016. Therefore, the current approved Prudential Indicators and Limits will continue to apply until such time.

10. CONCLUSION AND RECOMMENDATIONS

- 10.1 Treasury operations are undertaken within a dynamic and volatile environment, which can significantly affect the cost of borrowing and returns from investing. Given that annual interest charges are currently in the region of £10M per annum and on a rising trend, the setting of an appropriate strategy is viewed as essential to ensure that the Council is not exposed to undue risks and costs. The strategy outlined in this report is, therefore, designed to ensure that the Council achieves the best possible rates on its borrowings and investments, at the minimum level of risk in light of prevailing and forecast market conditions. Security and liquidity of sums invested remain the primary objectives over yield.
- 10.2 The Investment Strategy outlined in this report covers all matters required by the Regulations, and lists the Permitted Investments and the strategy for undertaking investments. The Permitted Investments carry a low level of risk, and they will be reviewed on an ongoing basis as the economic environment changes and new investment products are introduced in the financial markets. However, no changes to the Permitted Investments are proposed at this stage. The 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.
- 10.3 The report also outlines the link between Treasury Management and the Capital Budget and proposes that the Prudential Indicators, as required under the Prudential Code, are not determined until the Council set a new Composite Capital Budget in June. It is therefore proposed that the current approved Indicators, which are based on the current Capital Budget, remain in place until that time.
- 10.4 It is recommended that the Council:
1. Approves the six year Treasury Strategy for 2016/17 to 2021/22, as detailed in this report, which is submitted in accordance with the Council's approved Treasury Management Practices (TMP).
 2. Approves the Permitted Investments and Investment Strategy for 2016/17 outlined at Sections 5 and 6 and detailed at Appendices III and IV of this report.
 3. Approves that the current Prudential Indicators for 2015/16 to 2020/21 continue to apply until after the Council consider a new Composite Capital Budget in June 2016.

Author(s)

Name	Designation	Contact Details
John Jennings	Senior Accountant	jjennings@pkc.gov.uk 01738 475564

Approved

Name	Designation	Date
John Symon	Head of Finance	11 February 2016

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Council Text Phone Number 01738 442573

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

1.1. Corporate Plan

1.1.1. The Council's Corporate Plan 2013 – 2018 lays out five 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:

- (i) Giving every child the best start in life;
- (ii) Developing educated, responsible and informed citizens;
- (iii) Promoting a prosperous, inclusive and sustainable economy;
- (iv) Supporting people to lead independent, healthy and active lives; and
- (v) Creating a safe and sustainable place for future generations.

1.1.2 This report relates to all of these objectives.

2. Resource Implications

2.1. Financial

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

2.2. Workforce

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

2.3. Asset Management (land, property, IT)

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

3. **Assessments**

3.1. Equality Impact Assessment

3.1.1. 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.

3.1.2. 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.

3.2. Strategic Environmental Assessment

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

3.2.2. 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.

3.3. Sustainability

3.3.1. 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.

3.3.2. 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, Capita 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 (Capita Asset Services Ltd).

Appendix III – Permitted Investments.

Appendix IV – Annual Property Investment Strategy 2016/17

Outlook for Interest Rates

The data below shows a variety of forecasts published by a number of institutions. The forecast within this strategy has been drawn from these diverse sources and Council officer's own views.

Capita Asset Services Forecast for Interest Rates

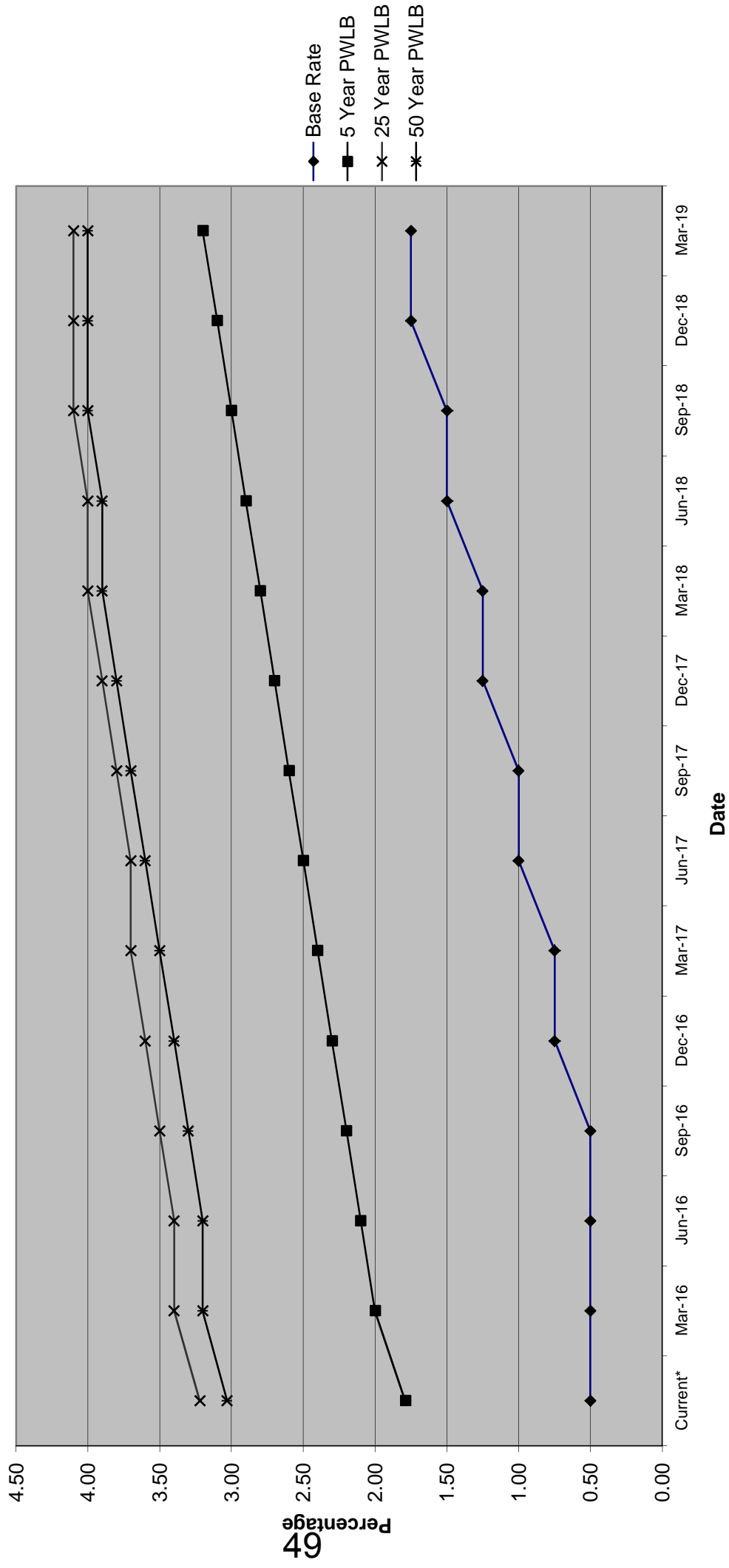
(%)	Current*	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Bank Rate	0.50	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	1.75
5 Yr PWLB	1.79	2.00	2.10	2.20	2.30	2.40	2.50	2.60	2.70	2.80	2.90	3.00	3.10	3.20
10 Yr PWLB	2.46	2.60	2.70	2.80	2.90	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.60	3.70
25 Yr PWLB	3.22	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10	4.10
50 Yr PWLB	3.03	3.20	3.20	3.30	3.40	3.50	3.60	3.70	3.80	3.90	3.90	4.00	4.00	4.00

* current rates taken as at 29 January 2016.

Capital Economics forecast for interest rates

(%)	Current*	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
Bank Rate	0.50	0.50	0.75	0.75	0.75	1.00	1.00	1.00	1.25
5 Yr PWLB	1.79	2.60	2.70	2.80	3.00	3.10	3.20	3.30	3.50
10 Yr PWLB	2.46	3.35	3.45	3.45	3.55	3.65	3.75	3.85	3.95
25 Yr PWLB	3.22	3.35	3.45	3.45	3.55	3.65	3.75	3.85	3.95
50 Yr PWLB	3.03	3.40	3.50	3.50	3.60	3.70	3.80	3.90	4.00

Forecast for Interest Rates
(Capita Asset Services Ltd)



**PERTH AND KINROSS COUNCIL
PERMITTED INVESTMENTS 2016/17**

Treasury Management Investment Type	Total Limit	Individual Limit	Objectives	Counterparty	Risk Assessment	
					Market	Liquidity
Fixed Deposits with approved Banks and Building Societies up to 1 year	Unlimited	per policy	Guaranteed investment returns	Low risk applied in Treasury Policy	Risk of increase in interest rates	Low risk of tied-up funds
Instant Access Deposits with approved Banks and Building Societies	Unlimited	per policy	Maximise liquidity	Low risk applied in Treasury Policy	Risk of fall in interest rates	No risks
Variable Rate deposits with approved Banks and Building Societies up to 1 year	35%	per policy	Maximise returns	Low risk applied in Treasury Policy	Risk of fall in interest rates	Low risk of tied-up funds
Fixed Deposits with approved Banks and Building Societies over 1 year up to 3 Years	£10M	per policy	Guaranteed longer term investment returns	Increased risk applied in Treasury Policy	Risk of increase in interest rates	Higher risk of tied-up funds
Variable Rate deposits with approved Banks and Building Societies over 1 year up to 3 years	Lower of 35% or £5M	per policy	Maximise longer term investment returns	Increased risk applied in Treasury Policy	Risk of fall in interest rates	Higher risk of tied-up funds
AAA, V1+/MR1+ rated Money Market Funds	Unlimited	per policy	Maximise returns on smaller deposits	Low risk applied in Treasury Policy	Risk of fall in interest rates	No risk
Fixed Rate deposits with Local Authorities	Unlimited	per policy	Maximise security on fixed returns	Low risk applied in Treasury Policy	Risk of increase in interest rates	Low risk of tied-up funds
Variable Rate deposits with Local Authorities	35%	per policy	Maximise security on variable returns	Low risk applied in Treasury Policy	Risk of fall in interest rates	Low risk of tied-up funds

Notes:

1. All investments to be made in sterling
2. The policy referred to above is defined in TMP4, Schedule 4.6 (Approved Lending & Investment Policy)
3. Individual limits apply to all investment types in aggregate
4. Variable rate limit (excluding instant access accounts) applies to all investment types in aggregate
5. The limit for amounts invested over 1 year refer to the remaining period to maturity of investments

**PERTH AND KINROSS COUNCIL
PERMITTED INVESTMENTS 2016/17**

Other Investment Type	Total Limit	Individual Limit	Objectives	Risk Assessment		
				Counterparty	Market	Liquidity
Loans to third parties, including "soft loans"	To be reviewed upon each application	Subject to approval by the Council	For operational Service requirements	Higher risk	High risk, often given on interest-free terms, but met by Service.	Higher risk of tied-up funds
Investment Properties (controls and limits per Investment Property strategy document)						

Property Investment Strategy 2016/17

1. Introduction

The Local Government in Scotland Act 2003 included specific powers (Section 40) for local authorities to invest money in accordance with regulations approved by Scottish Ministers. Under these powers, the Local Government Investments (Scotland) Regulations 2010 were approved by Scottish Ministers on 1 April 2010, and came into effect from that date.

Each Council is granted the freedom to determine what types of investments they may make, and the level of risks acceptable to each Council in making investments must be explicitly stated. These must be approved by the Council in advance of each financial year.

The elements of the Council's commercial investment property estate which are held solely to earn rental income and/or capital appreciation fall within the scope of the regulations. The requirements outlined for financial investments therefore apply to these Council property investments. The Council is required to approve an Investment Strategy before the start of each financial year.

This paper is the Council's Property Investment Strategy, which forms part of the Councils requirement for an annual overall Investment Strategy.

2. Context

The Council does not normally acquire property solely for investment purposes.

New property acquisitions generally support one of the functions noted below and do not therefore fall within the scope of the Local Government Investments (Scotland) Regulations 2010;

- **direct service provision** e.g. new school sites and land for road junction improvements, or
- **Socio economic or economic development** e.g. land and buildings held on the Commercial Property Investment Programme (CPIP) to support a supply of land to businesses and industry.

The Regulations do, however, cover those parts of the commercial estate which are generally held to provide rental income. Predominantly these properties would have initially been acquired to meet a socio economic or economic development need, but having met that need at some time in the past, are now retained for the rental income they produce. The portfolio has therefore been developed over a long period and includes properties such as precinct shops acquired to serve local communities; offices which have

become surplus to operational needs; shops, offices and industrial sites purchased to facilitate redevelopment etc.

3. Strategic Vision for the Property Investment Portfolio

To move from the historic legacy to a more balanced sustainable portfolio to meet the future financial and corporate objective needs of the Council.

4. Corporate Aims and Objectives

The overall aim of the Property Investment Strategy is to support the objectives of the 2013/18 Corporate Plan.

The Property Investment Strategy supports corporate objectives by seeking to:

- Maximise and enhance socio economic and economic development opportunities to the benefit of local communities and businesses.
- Encourage new business take up, retain and enhance existing businesses and opportunities.
- Maximise community benefit through the provision of land and premises.
- Clearly identify the primary purpose for holding individual assets (and groups of assets) and apply appropriate management, retention and disposal policies, and procedures relevant to the asset categories by completing a review of the commercial property portfolio.
- Optimise financial return and best value.

5. Current Portfolio

Perth and Kinross Council's commercial estate consists of approximately 250 properties together with land held for future investment, infrastructure or disposal;

The properties currently held for income generation are managed through the use of lease agreements and the number of leases per asset type is approximately;

35 Shops
15 Offices
39 Industrial premises
133 Ground leases
28 Miscellaneous properties

The anticipated gross income for 2015/16 is currently £1,898,000. The provisional budgeted income for 2016/17 is £1,729,000, and regular appropriate monitoring and reporting of the position will be provided.

The Council holds a number of town and village halls, leisure facilities etc which are “let” to management committees, community groups and Live Active. As these assets are effectively managed to provide functions which would otherwise be provided by the Council they are classified as operational properties and lie outwith the remit of the regulations.

6. Categorisation

In developing a strategy for managing the commercial property portfolio it is necessary to define the reasons for retaining non-operational properties, to categorise the individual properties, and to apply different criteria to ensure that the appropriate return (financial, economic or community benefit) required from that investment.

The portfolio can be split into the following categories, with each requiring a different approach when deciding future management and retention policies.

The categories adopted are:

- Socio economic
- Economic development
- Operational occupation
- Revenue generation
- Housing Revenue Account (non-Housing)

7. General Strategic Principles

There will be a presumption against the acquisition of new heritable properties purely for financial investment purposes.

- Heritable property will only be acquired to support the Council’s strategic objectives, with the property’s investment potential being secondary to securing Council objectives.

Existing Council owned properties which become surplus to operational requirements will be disposed of in line with the Disposal of Land and Buildings Policy.

- There will be a presumption against the retention of surplus property assets for financial investment purposes unless the retention supports Council strategic objectives. As with new acquisitions, the assets investment potential is secondary to securing Council objectives

There are a number of general principles that will be applied to the management of the retained investment portfolio;

- Day to day decisions on the management of the portfolio should support the efficient & effective delivery of the Council's strategic and operational objectives.
- The portfolio should reflect strategic and operational objectives by clearly differentiating between those held for the benefit of the community (economic development and socio economic) and those retained purely as investment opportunities.
- "Added value" principles should apply – investment and expected returns should be on the basis of what is "best for communities" rather than concentrating on purely financial return.

8. Specific Strategic Principles

The Council will use the portfolio to support corporate objectives by adopting the following principles in the future management of the various categories of commercial properties:

- **Socio Economic Portfolio** – Held primarily for promotion or enhancement of the Council's 5 strategic objectives for securing the future. Revenue generation for this category, although important and justifiable, is secondary to supporting Council objectives.
- **Economic Development Portfolio** - Held primarily to support strategic objectives but with an emphasis on supporting Objective (iii) - a prosperous, sustainable and inclusive economy. The portfolio will be used to safeguard, control and promote the use of land for economic development and regeneration through;
 - **Business Opportunity enhancement** – Land and buildings acquired or provided to facilitate and encourage business opportunities in local communities where the private sector has failed to provide infrastructure due to market conditions. There is a general presumption that this provision will be made available at sustainable market levels but with an acceptance that provision may have to be subsidised to generate development in certain areas.
 - **Start-up Workshop Units** – units should be held to encourage new and expanding businesses locate and flourish, particularly in rural Perth & Kinross. Such units, where available, should be on short term lets with flexible terms to assist firms become established.
- **Operational Occupation** – There is a presumption against properties held on the commercial estate being occupied by Council Services. Properties held for revenue generation may however be occupied by Council Services, with that service meeting the full cost of occupation, including payment of a market rent were appropriate.

- **Revenue Generation** – Properties will generally only be held for rental income generation whilst generating an adequate and competitive return. There will be a presumption in favour of disposal of poorly performing properties including, for example, units which are difficult to let or which are expensive to manage, unless these form part of a larger grouping where disposal of part would be detrimental to the value of the whole e.g. where they form part of a row of workshop units.

In appropriate circumstances, consideration will be given to sales to sitting tenants if the disposal would not adversely affect the remaining portfolio; but only at full market value and at a price economically advantageous to the Council e.g. sales may be resisted at times of economic downturn when sale prices are unfavourable.

Poorly performing multi occupancy investments; industrial estates, rows of shops etc will be considered for disposal to either existing occupiers or as investments.

- **Housing Revenue Account (non-housing)** – There is no general presumption in favour of the disposal of investment properties held on the Housing Revenue Account (HRA) and the Executive Director of Housing & Community Care will be consulted prior to disposal of any HRA assets. Scottish Ministers' consent is also required prior to the disposal of land and property on the Housing Revenue account. The same principles as applied to the rental income generating portfolio will generally be applied to the HRA portfolio.

9. Portfolio Management Principles

General:

- Establish criteria for differentiating between the property investment categories and allocate each property to the appropriate category for future management purposes.
- Treat all tenants within each investment category equitably.
- Establish realistic and manageable performance indicators relevant to each portfolio category for monitoring revenue potential and economic development benefits.
- Develop procedures/indicators for managing future allocations between asset classifications e.g. triggers for transferring from economic development to revenue generation: revenue generation to disposal for non-performing assets.
- Undertake planned maintenance based on condition surveys and ensure that tenants comply with their obligations.
- Carry out timely lease renewals and rent reviews.
- Minimise risk by ensuring tenants have adequate financial standing to meet their obligations.
- Minimise rent arrears through timely intervention.

- Actively pursue outstanding rent arrears.
- Minimise voids by actively marketing vacant properties for lease or sale as appropriate to the asset.
- Support capital receipt generation (disposal of poorly performing assets) whilst seeking to achieve a balance between revenue and capital.

Socio Economic Portfolio:

- Clearly identify any “subsidy” level in leases to future socio economic and community lets.
- Only consider future lets on socio economic grounds where supported by a business case clearly identifying the community benefits and financial viability of the proposed let and having identified a sponsoring Service within the Council to provide support.

Economic Development Portfolio:

- There will be a presumption against the sale of individual units identified as start-up units and disposals will therefore be resisted.
- The sale or lease of other land and premises held for economic development purposes will be considered against the economic benefit to the local community and business needs.

Revenue generating portfolio:

- Always seek to maximise the return from the investment by applying market rents to all properties held in this category.
- Wherever practical, identify and allocate all running costs associated with the portfolio including “hidden” costs e.g. management costs.
- Monitor return on investment.
- Regularly review portfolio performance.
- Assess requests to sell from sitting tenants against the return on investment and the impact of sale on any remaining holdings in the immediate area.
- Manage the portfolio to maximise returns, balancing maintenance expenditure requirements against capital and rental growth potential.
- Investigate options for investment to maximise and maintain revenue streams.

HRA (non-housing) Portfolio:

- Unless identified by the Executive Director of Housing & Community Care as a property held for socio economic or economic development purposes, manage the portfolio on terms consistent with the management of the general revenue generating portfolio.
- Consult with the Executive Director of Housing and Community Care prior to agreeing to the disposal of investment properties, providing advice on whether disposal represents a good return on the investment.

10. Risk Management

Risk of falling rental income

A substantial unforeseen decrease in projected rental income could present a risk to the Council's revenue planning. Rental forecasts are regularly reviewed and managed in consultation with the Head of Finance.

The major risks affecting income potential are;

- Changing market conditions and
- Reducing rental income through disposal of investment properties.

Changing market Conditions – Low to Medium Risk

The risk of a substantial unanticipated decrease in income resulting from changes in market conditions was previously considered to be "Low" as leases tend to terminate on set dates, with a relatively small proportion terminating within a single year. The risk element rose to "Low to Medium" for 2013/14 due to challenging economic conditions, particularly in the retail sector, and remains at this level. Any likely reduction in income can, however, generally be anticipated. As leases terminate, even if unanticipated, the Council retains the capital asset which can be made available for re-letting or disposal. The current economic climate may however continue to make re-letting challenging.

Disposal of investment properties – Low Risk

Disposal of investment properties will result in a capital receipt, but the consequence of this will be the loss of rental income from the asset. Decisions to dispose of major assets will therefore affect income. Disposal will be discussed with the Head of Finance and a programme agreed as appropriate to support the Council's revenue budget and capital programme needs.

Risk associated with new investment acquisitions

Procedures are in place to assess and manage the risk attached to any new investment proposal as the acquisition will be subject to a full business case analysis and risk assessment by the appropriate corporate group and will require subsequent Committee approval.

11. Strategy Action Plan

The strategic vision to move from the historic legacy to a more balanced sustainable portfolio to meet the Council's strategic objectives and to secure the future financial viability of the commercial portfolio will be achieved through;

- the assessment and classification of each property as either socio-economic, economic development, revenue generating or HRA.
- a review of the commercial estate to determine each property's investment potential and viability, and

- by bringing forward a sustainable programme of assets for disposal to the appropriate Committee of the Council.

The assessment, classification and review of the portfolio is currently being reviewed by the Council's Estates Team and is due to be reported shortly. The findings will inform the emerging framework for development and investment in Perth as part of the work being undertaken nationally to develop a consistent approach to investment in the Scottish cities and City Investment Plans.