DATA LABEL: PUBLIC

WEST LOTHIAN COUNCIL

TREASURY MANAGEMENT PLAN FOR 2021/22

REPORT BY HEAD OF FINANCE AND PROPERTY SERVICES

A. PURPOSE OF REPORT

To seek approval for the Treasury Management Plan for 2021/22.

B. RECOMMENDATION

It is recommended that Council approves the 2021/22 Treasury Management Plan.

C. SUMMARY OF IMPLICATIONS

I.	**Council Values**	Being honest, open and accountable. Making the best use of our resources.
II.	**Policy and Legal (including Strategic Environmental Assessment, Equality Issues, Health or Risk Assessment)**	The plan complies with the policy set out in the council's Treasury Policy Statement, the requirements of the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code), the CIPFA Treasury Management in Public Services Code of Practice and the Local Government Investments (Scotland) Regulations 2010.
III.	**Implications for Scheme of Delegations to Officers**	No changes to current scheme of delegation for treasury management activities.
IV.	**Impact on performance and performance Indicators**	None.
V.	**Relevance to Single Outcome Agreement**	Effective prioritisation of resources will be essential to achieving key outcomes over the next two years.
VI.	**Resources - (Financial, Staffing and Property)**	The plan provides a framework for treasury management designed to manage risk whilst minimising the future borrowing costs of the council.
VII.	**Consideration at PDSP**	None.
VIII.	**Other consultations**	The council's treasury advisers have been consulted in relation to the forecasts and recommendations included in the plan.

D. TERMS OF REPORT

The attached Treasury Management Plan forms part of the overall corporate and financial planning process agreed by Council on 20 February 2017, and details the expected activities of the treasury function in 2021/22.

E. CONCLUSION

The attached plan for 2021/22 complies with the Treasury Management and Prudential Codes and the Scottish Investment Regulations. The plan will form the basis of the council's treasury activities during the financial year 2021/22.

F. BACKGROUND REFERENCES

CIPFA Treasury Management in Public Services Code of Practice and Guidance

West Lothian Council Treasury Policy Statement and Treasury Management Practices

CIPFA Prudential Code for Capital Finance in Local Authorities

Local Government Investment (Scotland) Regulations 2010

The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016

Housing Capital Investment Programme 2021/22 to 2022/23 – Report by Depute Chief Executive to West Lothian Council on 16 February 2021

Asset Management Strategy and General Services Capital Programme 2021/22 to 2027/28 – Report by Head of Finance and Property Services to West Lothian Council on 25 February 2021

Revenue Budget 2021/22 to 2022/23 – Report by Head of Finance and Property Services to West Lothian Council on 25 February 2021

Contact Person: Gillian Simpson, Accountant
gillian.simpson@westlothian.gov.uk
Tel No: 01506 283237

Donald Forrest
Head of Finance and Property Services
25 February 2021

DATA LABEL: PUBLIC

WEST LOTHIAN COUNCIL

Treasury Management Plan for 2021/22

February 2021

Treasury Management Plan 2021/22 Index

Appendices

1.0 INTRODUCTION

The annual Treasury Management Plan must be submitted to Council for approval in advance of the forthcoming financial year to comply with the revised Treasury Management Code and Scottish Investment Regulations.

On 20 February 2017, West Lothian Council agreed that the established integrated approach to corporate and financial planning should continue for the five year period 2018/19 to 2022/23, and that the revenue plan, capital plan and treasury management plan were to be considered at the same Council meeting on an ongoing basis.

The updated 2021/22 to 2022/23 Revenue Budget Report, including prudential indicators, is also presented to Council on 25 February 2021 for approval.

The borrowing and investment plans outlined in this report are based on the updated General Services Capital Investment Programme for 2021/22 to 2027/28 and the updated Housing Capital Investment Programme for 2021/22 to 2022/23, which was approved by Council on 16 February 2021.

This report has been produced with the assistance of forecasts from Link Asset Services, West Lothian Council's treasury advisors.

2.0 UPDATED PRUDENTIAL CODE AND TREASURY MANAGEMENT CODE

The CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) controls capital spending in a system based on self-regulation by authorities. The key objectives of the Prudential Code are to ensure that capital expenditure plans are affordable, external borrowing is prudent and sustainable, and that treasury management decisions are taken in accordance with professional good practice.

The Prudential Code requires the council to set a number of prudential indicators for the forthcoming three years. Appendix 1 includes the agreed treasury indicators that must be complied with when implementing the council's Treasury Management Plan.

In December 2017, CIPFA issued a revised Treasury Management Code of Practice and a revised Prudential Code.

Under the revised codes, all local authorities were required to prepare an additional report from 2019/20, a capital strategy report, to provide 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 sustainability.

The capital strategy report ensures that elected members on the full council fully understand the overall capital strategy, governance procedures and risk appetite entailed by this strategy, and includes capital expenditure, investments and liabilities and treasury management in sufficient detail to allow members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured.

In compliance with the revised codes, a review of the capital strategy approved by council on 19 March 2019, will be undertaken and presented to Council Executive by the end of March 2021.

CIPFA commenced a consultation in January 2021 in respect of proposed changes to the Treasury Management Code of Practice. The closing date for responses is 12 April 2021 and CIPFA intend to publish the revised code towards the end of 2021/22 with full adoption expected to be from 2022/23.

CIPFA have also announced that they will be reviewing the Prudential Code for Capital Finance in Local Authorities (2017) (Prudential Code). CIPFA states that it wishes to provide an opportunity for the sector to comment on the proposed changes. CIPFA are proposing to strengthen the provisions in the code as follows:

- The addition of sustainability and ensuring that capital expenditure is consistent with a local authority's corporate objectives (such as diversity and innovation) as well as the objectives in the Prudential Code.
- The introduction of new prudential indicators on affordability which are External debt to net service expenditure (NSE) ratio, and commercial income to net service expenditure.
- Further strengthening the requirements to assess the affordability of commercial activity within local authorities' capital strategies. CIPFA is to also publish further guidance on good practice for development of capital strategies, early this year.
- Within paragraph 45 of the Prudential code to state clearly that borrowing for debt-for-yield investment is not permissible under the Prudential Code. While recognising that commercial activity is part of regeneration, CIPFA does not believe it should constitute the primary purpose of investment nor give rise to an unnecessary risk to public funds.
- Any commercial investment undertaken should be consistent with statutory provision, proportionate to service and revenue budgets and consistent with effective treasury management practice.
- The introduction of the Liability Benchmark to promote good practice and the understanding of a local authority's debt management strategy in relation to capital investment.

The closing date for responses is 12 April 2021 and CIPFA intend to publish the revised code towards the end of 2021/22 with full implementation expected to be from 2022/23. A proposed council response will be reported to Council Executive in March 2021.

3.0 LOANS FUND REPAYMENT HOLIDAY

The Cabinet Secretary wrote to COSLA on 8 October 2020 regarding financial flexibilities for local government. The letter outlined three potential fiscal flexibilities which could provide local government with additional spending power to respond to the Covid-19 pandemic. Further details on the flexibilities were to be brought forward in statutory guidance.

One of the three flexibilities was a Loans Fund Repayment holiday which will permit local authorities to defer loans fund repayments due to repaid in either 2020/21 or 2021/22. The loans fund repayment holiday is only to be used for the purposes of addressing Covid-19 related costs. In addition, it is specified that it should only be used as a last resort and needs to be repaid within twenty years.

Following the announcement of the flexibilities, the Directors of Finance (DoF) and COSLA have been liaising with the Scottish Government to finalise the practicalities and to resolve ongoing technical and legislative issues. The revised legislation for the loans fund repayment holiday was laid in Parliament on 17 January, and was agreed by the Local Government and Communities Committee on 17 February. This will now be reported to the Scottish Parliament for final approval, which officials have advised is a formality.

Utilising the loans fund holiday in 2021/22 would release £6.6 million in general fund and £1.8 million in HRA to address Covid-19 pressures. This will result in an immediate recurring revenue budget pressure in 2022/23 which is incorporated in the revenue budget model.

4.0 CURRENT PORTFOLIO POSITION

The council's current debt and investment position at 31 January 2021 is as follows:

		£m	£m	Average Interest Rate
Fixed Rate Funding	Public Works Loan Board (PWLB)		538.6	
	Market		60.6	
			599.2	3.9%
Variable Rate Funding	Public Works Loan Board (PWLB)	-		
Temporary Funding	Market		0.0	0.0%
Total Debt			**599.2**	**3.9%**
Total Investments			**95.6**	**0.3%**

5.0 FORECASTS

The basis of the Treasury Management Plan lies with determining appropriate borrowing and investment decisions in the light of the anticipated movement in both long and short-term interest rates. The plan for 2021/22 is structured around the general forecasts of interest rates but, like any proposed plan, there will be flexibility of application dependent on prevailing economic conditions.

The Bank of England's Monetary Policy Committee (MPC) reduced the bank rate to 0.5% in March 2009. The bank rate remained at this level until August 2016, when it was cut further to 0.25%. There was a 0.25% increase in the Bank Rate in November 2017, and then a further increase to 0.75% on 2 August 2018. The Monetary Policy Committee (MPC) agreed on 11 March 2020 to decrease the bank rate to 0.25%, and then further reduced the rate from 0.25% to 0.10% in an emergency move to help control the economic shock of the coronavirus pandemic. At its meeting on 3 February 2021, the Committee voted unanimously for the Bank of England to maintain the bank rate at 0.10%. It was also announced at the meeting that its programme of quantitative easing would remain unchanged following the additional £150 billion announced at the outset of the second lockdown in November 2020.

The Bank of England has removed the possibility of negative interest rates for at least six months, as financial institutions are not equipped to implement them. If in six months, the economy is starting to grow strongly, there will only be a slight possibility of negative interest rates being applied. However, financial institutions have been requested to be prepared for this prospect so that, in the future, they could be utilised as a monetary policy tool if this was considered necessary.

The Capital Economics view is that the Bank rate will not rise for the next five years and even when it does, it will probably struggle to get to 1% within ten years.

The Consumer Price Index (CPI) measure of inflation was 0.5% in the final quarter of 2020 which is well below the Bank of England's 2% target, largely reflecting the direct and indirect effects of Covid-19. Much of the weakness of inflation reflects the impact of a number of specific temporary Covid-related factors, such as falls in energy prices and the Government's cut to VAT for certain services. These factors are expected to continue to have an effect on inflation in the first quarter of 2021, with CPI inflation, rising sharply towards the 2% target in the Spring as the reduction in VAT for certain services comes to an end. CPI inflation is projected to be close to 2% over the second and third years of the forecast period.

GDP is expected to fall by around 4% in the first quarter of 2021, which represents a decrease of 12% from the level in the final quarter of 2019, due to the tightening of restrictions to help contain the spread of the new strain of Covid. The impact of current restrictions is not expected to be as severe as in the second quarter of 2020, during the first lockdown. GDP is anticipated to rapidly recover towards pre-Covid levels during 2021 as it is assumed that the programme of vaccinations will enable restrictions to be eased. GDP is forecast to continue to grow over 2022 and 2023, but the pace of growth will slow down over these years.

Economic forecasting continues to be difficult with the outlook for the economy remaining highly uncertain. The MPC's central case projections for the UK assume that current Covid restrictions are in place until the end of the first quarter in 2021, before being relaxed over the second and third quarters as an increasing proportion of the population are vaccinated. There is uncertainty surrounding how the pandemic might evolve, for example, the potential emergence of further new strains of the virus along with how government, households, businesses and financial markets respond to those developments. Different developments could have material effects on UK and global activity as a whole.

The UK and EU agreed a new trading relationship, the Trade and Co-operation Agreement on the 24 December 2020 and it has been applied since 1 January 2021. The new trading relationship will result in barriers to trade, and as a result of this, trade between the UK and EU in both goods and services is likely to be lower than it would have been. In the MPC's February report it states that projected UK trade will be around 10.5% lower in the long-run under the new agreement and productivity and GDP around 3.5% lower, however, a large degree of uncertainty surrounds these projections. The MPC's February forecasts have assumed that trade and activity will be lower in the first half of 2021 as firms adjust to the introduction of new UK-EU trading arrangements. The reduction in exports and the impact on domestic supply chains is projected to lower GDP by around 1% in the first quarter of 2021, which reflects an assumption of reduction in demand as well as supply. These effects on trade are predicted to disperse by the end of the second quarter in 2021.

Forecasters believe the volatility of bond yields experienced in recent years will continue as investor fears and confidence moves between favouring more risky assets such as equities and safer government bonds.

The economic position has demonstrated steady growth in recent years, however, the UK economy entered into a recession in the second quarter of 2020 as a result of the Covid-19 pandemic. How the pandemic evolves represents the biggest risk to the UK economy going forward, however, further risks to the recovery and growth of the economy include:

- Mutations of the virus render current vaccines ineffective, and tweaked vaccines to combat these mutations are delayed, resulting in further national lockdowns or server regional restrictions.
- The Bank of England acts too quickly, or too far, over the next three years to raise the Bank Rate and causes UK economic growth, and increases in inflation to be weaker than forecast.
- Possibility of a major impact on UK and EU trade arrangements due to complications with customs paperwork or lack of co-operation in resolving significant issues.
- Weak capitalisation of some European banks, which could be undermined further depending on the extent of credit losses resulting from the pandemic.
- A resurgence of the Eurozone sovereign debt crisis.
- Geopolitical risks could trigger safe haven flows back to government bonds.

The forecast longer-term trend for gilt yields and PWLB rates is to rise gently, however, there are also likely to be periods of sharp volatility from time to time. With many unpredictable virus factors now being part of the forecasting environment, there is a risk that forecasts could be subject to significant revision during the next three years.

Based on the above, the forecast for interest rates is:

Short Term Interest Rates
The Bank Rate is forecast to remain at 0.1% throughout 2021 and 2022.

Medium and Longer Term Rates
Medium term interest rates are expected to be lower than longer term rates. Rates are forecast to remain constant for the remainder of 2021. The long term trend is for gilt yields, and therefore PWLB rates, to increase gradually due to the high issuance of bonds in major western countries and as investors move from bonds to equities. Five-year PWLB rates are forecast to rise from 0.9% in quarter 1 (Q1) 2021 to 1.0% in Q1 2022, with 25-year PWLB rates forecast to increase from 1.9% in Q1 2021 to 2.0% in Q1 2022. Appendix 2 draws together City forecasts of the bank rate and PWLB fixed interest rates.

6.0 CAPITAL FINANCE PLAN

6.1 Borrowing Requirement

The council's estimated total borrowing requirement for each of the next three years is shown below:

	2021/22 £m	2022/23 £m	2023/24 £m
New Borrowing	38.9	24.0	12.2
Replacement Borrowing	9.0	0.0	0.0
Total Borrowing Requirement	**47.9**	**24.0**	**12.2**

6.2 Borrowing Plans

The borrowing requirement in 2021/22 of £47.9 million is based on the General Services capital budget presented to West Lothian Council on 25 February 2021, and on the Housing capital budget approved by Council on 16 February 2021. For new borrowing, council officers, in conjunction with Link Asset Services, will continually monitor prevailing interest rates and market forecasts to identify the most opportune time for borrowing during the year. It is anticipated that replacement borrowing will be undertaken when existing borrowing matures, subject to available interest rates.

The uncertain economic outlook means that borrowing interest rates remain volatile, however initial assessments by commentators are that they will continue to be attractive. Short, medium and long-term fixed rates are all forecast to maintain constant during 2021 and to increase incrementally over 2022, with the short to medium term rates forecast to be cheaper than long term rates.

On 9 October 2019, HM Treasury wrote to all Chief Financial Officers in local authorities to inform them that the margins that would be applied to all borrowing from the PWLB would be immediately increased by 1%, to restore rates to the levels that were available in 2018, after a period of record low levels of borrowing rates during late 2018 and into 2019. The Chancellor subsequently announced, on 26 November 2020, that rates would be cut by 100 basis points for new loans arranged from this date, which reverts rates back to where they were previously in October 2019. It is hoped that this will assist local authorities moving forward with planned infrastructure projects by lowering the costs of borrowing.

The council continually monitors interest rates and consults with treasury advisors to determine the most opportune time to borrow throughout the year. A substantial proportion of the borrowing requirement for 2018/19 and 2019/20 was secured at the record low borrowing rates, which will help to assure the long term affordability and sustainability of the council's capital programmes.

The decrease in PWLB rates and the effect this will have on borrowing decisions will continue to be assessed, with the council committed to considering all funding options that provide best value, including continuing to monitor PWLB rates to take advantage of any opportunities to borrow that may arise, borrowing from other sources (within the parameters set out in the treasury plan) and the use of internal borrowing.

These forecasts show that various options are available for borrowing in 2021/22. Short and medium term rates are forecast to be cheaper than longer term borrowing throughout the year. Consequently, the council will borrow a spread of variable, short and medium term loans from the PWLB at the most opportune times during the financial year, however consideration may be given to longer term borrowing if attractive rates occur. It is anticipated that replacement borrowing will be secured when existing borrowing matures, subject to prevailing interest rates at that time.

A portion of the borrowing requirement could also be taken using Lenders Option Borrowers Option (LOBO) market loans however there are few of these products currently available in the market. LOBO borrowing would be for fixed periods up to 15 years and could be forward dated to reduce the cost of carry. The council will continue to liaise with Link Asset Services to identify opportunities to secure borrowing.

It is important to note that the plan adopted will be flexible and continually monitored against changes in money and capital market sentiments. Should there be any divergence between the actual position and the interest rates forecast the following action would be taken:

- **Significant risk of a much sharper rise in long and short term rates**
  In this event, the portfolio position will be reappraised with the likely action that fixed rate funding will be borrowed whilst interest rates are still relatively cheap securing borrowing at a rate that is acceptable to the council.

- **Significant risk of a sharp fall in long and short term rates**
  In this event, long term borrowings will be postponed and any opportunities for debt rescheduling from fixed rate funding into variable rate funding will be considered. This would allow the council to realise the benefit of reductions in interest rates.

6.3 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. A variety of options are provided to councils, so long as a prudent provision is made each year.

As previously agreed, the position on the repayment of loans fund advances is for the Asset Life Method to be used for all repayments, with repayments being made on an annuity basis, using a repayment period of 35 years and an annuity interest rate of 5.5%.

Using the approach outlined above, the expected transactions through the loans fund account for 2020/21 and 2021/22 are as follows:

Loans Fund Account Balances	**2020/21 Estimate £m**	**2021/22 Estimate £m**
Balance as at 1 April	636.3	643.2
Advance for the financial year	15.4	38.9
Repayments made for the year	(8.5)	(1.0)
Balance as at 31 March	**643.2**	**681.1**

The profile of future loan repayments is as follows:

Loans Fund Account Repayments	**General Fund £m**	**HRA £m**	**Total £m**
Year 1 (starting 2022/23)	8.3	2.7	**11.0**
Years 2-5	40.2	22.3	**62.5**
Years 6-10	85.5	37.0	**122.5**
Years 11-15	98.9	46.1	**145.0**
Years 16-20	86.1	54.2	**140.3**
Years 21-25	54.4	56.3	**110.7**
Years 26-30	24.6	41.2	**65.8**
Years 31-35	7.5	15.8	**23.3**
Total	**405.5**	**275.6**	**681.1**

The Loans Fund Repayment holiday will be taken in 2021/22. This amount has been calculated on the repayments due to be repaid in 2020/21, being £6.633 million for General Fund and £1.843 million for HRA, giving a total of £8.476 million. The draft legislation states that the maximum value of the holiday is the planned 2020/21 repayment whether it is taken in 2020/21 or 2021/22. When this is deducted from the repayments due for 2021/22, this leaves a residual repayment balance of £1.009 million still to be repaid for 2021/22.

6.4 External v Internal Borrowing

Given the uncertain outlook for economic growth, the low bank rate is expected to continue until the end of 2022 with the council receiving lower returns for investments but also being able to secure external borrowing at attractive rates. This position allows authorities to consider whether it is more beneficial to undertake external borrowing or pay for the capital programme with internal borrowing by reducing existing investments. Reducing investments would limit exposure to counterparty risk but could increase liquidity risks where the council's reserves and balances are not cash backed.

While interest rates are low, internal borrowing is an effective use of working capital and balances in the short term, however the council's treasury advisor believes that the longer run trend is for PWLB rates to gradually rise. It is therefore considered best value for the council to have a mix of external and internal borrowing. This will enable internal borrowing to be utilised to reduce the cost of carry and overall financing costs in the short term, but opportunities for external borrowing can still be secured at the most opportune moments while rates are still at reasonable levels. This allows the council to secure good rates to ensure that the capital plans to 2027/28 are not compromised due to increased borrowing rates in the future.

7.0 ANNUAL INVESTMENT PLAN

7.1 Investment Policy

The Local Government Investments (Scotland) Regulations 2010 came into force in April 2010. The Regulations require local authorities to consider the totality of their investment activity and, as such, have a wider application than the CIPFA Treasury Management Code. The Regulations apply to a range of investments including temporary surplus funds with banks and similar institutions, shareholding in companies or joint ventures, loans to group undertakings and third parties and investment properties. The Regulations require local authorities to manage risks to the capital sum invested and optimise the return consistent with those risks.

The council's investment priorities are the security of capital and the liquidity of its investments. The council aims to achieve the optimum return on its investments commensurate with appropriate levels of security and liquidity. The risk appetite of the council is low in order to give priority to security of its investments. Investment instruments identified for use are listed in Appendix 3 as permitted investments. Any investment not listed will be ultra vires in line with the Regulations and will not be entered into by the council. Before any new investment mechanism can be used, approval would be required by the Council to amend the permitted investment list.

7.2 Creditworthiness Policy

The council's treasury management advisor, Link Asset Services, provides credit ratings from the three main credit rating agencies, Fitch, Moody's and Standard & Poor's. The council uses the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties.

All credit ratings are monitored regularly and the council is alerted by email to rating changes from all three agencies. If a rating downgrade results in the counterparty no longer meeting the council's minimum criteria, its further use as a new investment option will be withdrawn immediately. Sole reliance is not placed on the use of credit ratings supplied by our treasury advisors. In addition, the council also uses the financial press, Reuters news, market data and information on government support for banks, including the credit ratings of government support.

The council's policy in prior years was only to invest in appropriately rated UK banks and building societies augmented, when available, by UK local authorities and public bodies. This position was enhanced in recent years with the Council agreeing an increase in the counterparty limit for part-nationalised UK banks, revising the maximum percentage of investments in AAA rated Money Market Funds to 35% and adding certificates of deposit with appropriately rated financial institutions to the counterparty list. These changes increase the counterparty options available, without sacrificing the security of the council's funds. On this basis, the council's current approach will be continued.

Recent changes to UK legislation have meant that the largest UK banks were required to separate their core retail banking services from their investment and international banking activities by 1 January 2019, known as 'ring-fencing'. Ring-fencing is a regulatory initiative created in response to the global financial crisis in order to improve the resilience and resolvability of banks by changing their structure. In general, activities offered from within a ring fenced bank will be focused on lower risk, day to day, core activities, while more complex and 'riskier' activities are required to be housed in a separate entity, a non ring-fenced bank. This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included in the process may have changed, the fundamentals of credit assessment have not. The council will continue to assess the creditworthiness of the newly formed entities as outlined above, and those with sufficiently high ratings will be considered for investment purposes.

7.3 Borrowing in Advance

The Local Government Investments (Scotland) Regulations 2010 require local authorities to set out their approach to borrowing in advance in the Treasury Management Plan. Borrowing in advance is defined in the Regulations as any borrowing undertaken that results in total external debt exceeding the capital financing requirement (CFR) for the following twelve month period.

The council will not borrow more than, or in advance of its needs, purely in order to profit from the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the council can ensure the security of funds temporarily invested. Any advance borrowing will be reported as part of the next Treasury Management report to the Council, however it is not planned that the council will borrow in advance during 2021/22 due to the current low interest rate environment creating a cost of carry, meaning that the cost of borrowing funds in advance would far outweigh any interest that would be received by investing the funds, and due to the limited number of counterparties available.

7.4 Investment Plans

In 2021/22, the general services capital programme will be partially funded by application of the capital fund. By using the fund, the level of investment held by the council will reduce. The level of investment at the end of 2021/22 is forecast to be £84 million compared to £95 million at the end of 2020/21. There will be fluctuations in the level of investment during the year arising from cash flow requirements and new borrowing decisions. The council's policy of investing only with appropriately rated UK banks and building societies and AAA rated money markets is considered to be risk averse, particularly in the light of the recapitalisation of certain UK banks by the UK Government. The council's estimated cash balance for each of the next three years is shown below:

	2021/22 £m	2022/23 £m	2023/24 £m
Cash Balances Managed by the Authority			
1 April	95.0	84.4	38.2
31 March	84.4	38.2	28.6
Change in year	(10.6)	(46.2)	(9.6)

Current investment rates vary from 0.20% and under for short periods to 1.05% for investments of a year. Based on the predicted continued period of low investment rates, the best value option for the council is to weight investments to longer periods, as much as possible within cash flow considerations, with a view to locking in higher rates of return than may be available from current short-term investment rates. To date, investments with a maturity of greater than a year have only been in government backed banks to ensure security of funds.

Since the beginning of the Covid-19 pandemic in 2020, the council has opted to utilise short-term investments in order to ensure there are no issues with liquidity in the event of any unforeseen circumstances. This will continue to be the approach going forward into the new year as the current rates are so low for short-term and long-term investments.

7.5 Permitted Investments

The Local Government Investments (Scotland) Regulations 2010 require local authorities to specify the investments that will be used in the forthcoming financial year. Any investment not listed as a permitted investment within the Treasury Management Plan will not be in accordance with the Regulations and will as a result be ultra vires.

Investments are subject to a number of risks which require to be effectively managed. The risks, and the controls to mitigate them, are summarised as follows:

- **Credit and Counterparty Risk Management** – this is the risk of a counterparty failing to meet its contractual obligations, effectively the risk of default. The council has always invested with appropriately rated UK banks and building societies. The council also uses AAA rated money market funds and other local authorities, as these are regarded as unlikely to default. This policy is considered risk averse particularly in the light of the financial support provided by the UK government to the UK banking sector. There will be no change to this policy although previous rating updates have severely constrained available counterparties.

- **Liquidity Risk Management** – this is the risk that cash will not be available when required creating additional unbudgeted costs. The council has effective cash flow forecasting up to twelve months in advance, which accurately forecasts the cash requirements. A proportion of the council's reserves and balances are expected to be used in 2021/22, with drawdowns being built into the council's medium and long-term cash flow forecasts. The use of highly liquid money market funds, and the council's overnight account for some shorter term investments, also ensures that this risk is minimised.

- **Market Risk** – this is the risk to the capital amount of the investment, effectively creating a loss of capital (i.e. the council would not receive back the amount originally invested). The council will not invest in any product which risks the value of the capital sum. For certificates of deposit, the council will hold certificates until maturity to ensure that the full amount invested is returned to the council.

- **Interest Rate Risk** – this is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances. The council has set limits for its fixed and variable rate exposure in its Treasury Indicators and manages this risk by having a view of the future course of interest rates and having a treasury management strategy which aims to maximise investment earnings consistent with control of risk and seeks to minimise expenditure on interest costs on borrowing.

- **Legal and regulatory risk** – this is the risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly. The council will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations.

Appendix 3 details the permitted investments and maximum amounts that can be invested in them. It also includes reference to associated treasury risks and mitigating controls. Permitted investments include current investments in long term investments, share capital in companies and loans to third parties. Following a review under the International Financial Reporting Standards (IFRS), the council does not have any investment properties.

The maximum amounts that can be invested are summarised as follows:

- **Term Deposits and Bonds in UK Banks & Building Societies (Up to One Year)**
  The maximum amount that can be invested is 100%. The council has primarily invested in this sector to date, however money market funds have increasingly been used for temporary increases in balances.

- **Term Deposits and Bonds in UK Banks & Building Societies (One to Two Years)**
  The maximum investment in this category is £35 million as agreed by Council on 15 October 2013. As noted previously, the majority of the council's investments represent cash backed funds and reserves of which only a proportion is forecast to be used in the next two years. Consequently, a proportion of these core funds could be invested for periods of between one and two years. Investment will be restricted to nationalised or part nationalised banks to minimise credit and counterparty risk, whilst also increasing the potential yield on investments in the current low rate environment.

- The council only has one long term investment of £25,000 in Lothian Buses plc, which was inherited on the disaggregation of Lothian Regional Council in 1996. As these shares are not actively traded, there are no plans to sell this asset.

- Loans to home owners through the Empty Homes Loans Fund to make their property habitable. To date no loans have been issued under the scheme.

- Investment in West Calder High School DBFMCo Ltd to deliver a new West Calder High School through the Schools for the Future Programme. The maximum level of investment by the council would be £100 in equity, with the subordinated debt element being 1% of the total eligible cost of construction. It is expected that the maximum level of subordinated debt will be £350,000.

7.6 Investment Counterparties

Appendix 4 details current authorised institutions, their investment limits and investments made at 31 January 2021. Although the range of counterparties has reduced because of previous counterparty movements, there are no further changes proposed to the current counterparty lists at this stage. Officers will continue to monitor progress and liaise with Link Asset Services to ensure the security of the council's funds.

8.0 DEBT RESCHEDULING

Debt rescheduling involves the reorganisation of existing debt to reduce the interest charge and improve the maturity profile of outstanding debt.

Following the introduction of different rates for new borrowing and the early repayment of debt, an increase in the spread of rates has made debt rescheduling uneconomic. This significantly restricts the prospects for debt rescheduling, therefore it is unlikely that there will be opportunities to reschedule long term fixed rate PWLB debt to short variable and temporary debt during 2021/22.

9.0 CONCLUSION

The Treasury Management Plan for 2021/22 complies with the updated Treasury Management and Prudential Codes and the Local Government Investments (Scotland) Regulations 2010. The Council is asked to approve the plan which will be used for all treasury management activities in 2021/22.

Donald Forrest
Head of Finance and Property Services
25 February 2021

Appendix 1

PRUDENTIAL INDICATORS 2021/22

The following treasury indicators were presented to Council on 25 February 2021 as part of the 2021/22 to 2022/23 Revenue Budget.

The key objectives of the Prudential Code are to ensure that capital investment plans are affordable, prudent and sustainable. The Code sets eight prudential indicators designed to support and record local decision making. The following describes the purpose of key indicators and the implications for West Lothian Council of the proposed levels, values and parameters.

CAPITAL EXPENDITURE INDICATOR – Capital Financing Requirement

Purpose of the Indicator
The capital financing requirement measures the council's underlying need to borrow for a capital purpose. This is the council's total outstanding debt required to finance planned capital expenditure, including long term financing liabilities.

	2019/20 £'000 Actual	2020/21 £'000 Estimate	2021/22 £'000 Estimate	2022/23 £'000 Estimate	2023/24 £'000 Estimate
General Fund	474,550	470,409	485,808	478,022	466,412
Housing	247,716	255,477	275,574	293,787	299,136
Total	**722,266**	**725,886**	**761,382**	**771,809**	**765,548**

Implications
The capital financing requirement continues to rise throughout the period as the council's outstanding debt incorporates the additional borrowing required to finance the approved capital expenditure plans.

TREASURY & EXTERNAL DEBT INDICATOR – Authorised Limit for External Debt

Purpose of the Indicator
This limit provides a maximum figure to which the council could borrow at any given point during each financial year.

Authorised Limit for:	2021/22 £'000	2022/23 £'000	2023/24 £'000
Gross External Borrowing	783,155	801,937	776,599
Other Long-Term Liabilities	81,296	78,714	74,479
External Debt	**864,451**	**880,651**	**851,078**

Implications
The limit is based on capital investment plans and treasury management policy and practice. It allows sufficient headroom for unanticipated movements and the limit will be reviewed on an ongoing basis throughout the year. The council's capital financing requirement outlined above is less than the authorised limit for each of the three years. If the authorised limit is liable to be breached, a report will be presented to Council with recommendations on how it can be managed.

TREASURY & EXTERNAL DEBT INDICATOR – Operational Boundary for External Debt

Purpose of the Indicator
This indicator is a management tool for in year monitoring and is lower than the authorised limit. It is based on an estimate of the most likely level of external borrowing.

Operational Boundary for:	**2021/22 £'000**	**2022/23 £'000**	**2023/24 £'000**
Gross External Borrowing	773,155	791,937	766,599
Other Long-Term Liabilities	80,296	77,714	73,479
External Debt	**853,451**	**869,651**	**840,078**

Implications
This indicator is consistent with revised capital investment plans and with treasury management policy and practice. It is sufficient to facilitate appropriate borrowing during the financial year and will be reviewed on an ongoing basis.

TREASURY & EXTERNAL DEBT INDICATOR – Actual External Debt

Purpose of the Indicator
This is a factual indicator showing actual external debt for the previous financial year.

	31 March 2020 £'000
Actual External Borrowing	620,570
Actual Other Long-Term Liabilities	85,590
Actual External Debt	**706,160**

TREASURY MANAGEMENT INDICATOR

This indicator intends to demonstrate good professional practice is being followed.

1. **Adoption of the CIPFA Treasury Management Code**

   The CIPFA Treasury Code was adopted on 25 March 1997 as an indication of good practice. In line with the fully revised Treasury Code, the Treasury Plan for 2021/22 is reported to the full Council for approval. The annual report on 2020/21 treasury activities will be presented to the Council in the first half of 2021/22.

2. **Upper limits for fixed and variable rate borrowing to 2022/23**

   The proposed limit for fixed rate borrowing is 100% and the proposed limit for variable rate borrowing is 35%. These limits mean that fixed rate exposures will be managed within the range of 65 to 100% and the maximum exposure to variable rate borrowing will be 35% of total debt. This is a continuation of current practice.

3. **Maturing structure of fixed rate borrowing for 2021/22**

   These parameters control the extent to which the council will have large concentrations of fixed rate debt needing to be replaced at times of possible uncertainty over interest rates. The limits for fixed rate borrowing are as follows:

	Proposed Upper Limit	Proposed Lower Limit
Under 12 months	35%	0%
12 months and within 24 months	35%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and over	100%	25%

4. Total principal sums invested for periods longer than 364 days

The Local Government Investment (Scotland) Regulations 2010 allows investments for periods longer than 364 days. Consistent with the decision of the Council on 15 October 2013, the maximum that can be invested is £35 million to ensure security of funds.

The treasury management indicator confirms sound professional practice is being followed by the council in undertaking treasury management. The proposed values and parameters will provide sufficient flexibility in undertaking operational treasury management.

Appendix 2

OUTLOOK FOR INTEREST RATES

Link Asset Services View interest rate forecast – February 2021

(%)	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022
Bank Rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
5yr PWLB	0.90%	0.90%	0.90%	0.90%	1.00%	1.00%	1.10%	1.10%
10yr PWLB	1.30%	1.30%	1.30%	1.30%	1.40%	1.40%	1.50%	1.50%
25yr PWLB	1.90%	1.90%	1.90%	1.90%	2.00%	2.00%	2.10%	2.10%
50yr PWLB	1.70%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%

Capital Economics interest rate forecast – January 2021

(%)	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022
Bank Rate	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
5yr PWLB	0.80%	0.85%	0.90%	0.95%	0.95%	0.95%	0.95%	0.95%
10yr PWLB	1.15%	1.20%	1.25%	1.30%	1.30%	1.30%	1.30%	1.30%
25yr PWLB	1.80%	1.80%	1.80%	1.80%	1.80%	1.80%	1.80%	1.80%
50yr PWLB	1.70%	1.70%	1.70%	1.70%	1.70%	1.70%	1.70%	1.70%

Appendix 3

WEST LOTHIAN COUNCIL PERMITTED INVESTMENTS

Permitted Investment Instrument	Minimum credit rating	Maximum Percentage of Total Investments	Treasury Risks	Mitigating Controls
Cash Investments up to one year				
Term Deposits and Bonds – UK Banks and Building Societies	Equivalent to Fitch's rating of FI short term A long term	Up to 100%	There is minimal risk to the value of principal invested. Consideration needs to be given to credit ratings to ensure appropriate counterparties are used. Liquidity risk that funds are not available when required.	Adoption of lowest rating from all three rating agencies to determine creditworthy counterparties. Cash flow forecasting undertaken to identify when funds will be required. Also use overnight account for daily access to funds.
Term Deposits – Local Authorities and Public Bodies	Local Authorities & Public Bodies are not awarded credit ratings	20%	Counterparty risk is very low as this is considered UK Government debt and there is no risk to value.	No controls required as investment is with the UK Government and has minimal risk.
Money Market Funds	AAA	35%	Pooled cash investment vehicle with very low counterparty, liquidity and market risk.	The council will only use funds with a constant net asset value or low volatility net asset value to ensure minimal risk to market value. Funds required to be AAA rated to limit counterparty risk and instant access to ensure liquidity.
Debt Management Agency – Deposit Facility	UK Government	20%	Minimal counterparty or liquidity risk as deposit is with the UK Government.	No controls required as investment is with the UK Government and has minimal risk.
Treasury Bills	UK Government	20%	Minimal counterparty or liquidity risk as deposit is with the UK Government. Potential market risk due to longer term movements in interest rates.	No general controls required as investment is with the UK Government. All investments are short term and held to maturity therefore minimal risk to value from resale on secondary market.

Appendix 3

WEST LOTHIAN COUNCIL PERMITTED INVESTMENTS

Permitted Investment Instrument	Minimum credit rating	Maximum Percentage of Total Investments	Treasury Risks	Mitigating Controls
Cash Investments up to one year				
Certificates of Deposit	Equivalent to Fitch's rating of FI short term A long term	20%	There is minimal risk to the value of principal invested. Consideration needs to be given to credit ratings to ensure appropriate counterparties are used. Liquidity risk that funds are not available when required.	Adoption of lowest rating from all three rating agencies to determine creditworthy counterparties. Cash flow forecasting undertaken to identify when funds will be required. Deposit will be held to maturity to ensure that the full amount invested is returned to the council. Investments will only be for periods of three to twelve months.
Cash Investments between one year and up to two years				
Term Deposits and Bonds – UK Banks and Building Societies	Nationalised or part nationalised UK Banks	£35 million	There is minimal risk to the value of principal invested. Consideration needs to be given to credit ratings to ensure appropriate counterparties are used. Liquidity risk that funds are not available when required.	Adoption of lowest rating from all three rating agencies to determine creditworthy counterparties. Cash flow forecasting undertaken to identify when funds will be required.
Non-Treasury Investments				
Long Term Investment - £25,000 £1 shares in Lothian Buses plc	This is the share of Lothian Buses plc allocated to the council on the disaggregation of Lothian Regional Council in 1996	£25,000 £1 shares	This is a service investment which may exhibit market risk.	Shares will not be sold therefore market changes will have no impact. Ownership is supported by service requirements and must be approved by elected members.

Appendix 3

WEST LOTHIAN COUNCIL PERMITTED INVESTMENTS

Permitted Investment Instrument	Minimum credit rating	Maximum Percentage of Total Investments	Treasury Risks	Mitigating Controls
Non-Treasury Investments				
Loans to Third Parties – Small Business Loans	Small amounts not subject to credit ratings	At 31 March 2020, there were no outstanding loans.	Counterparty and market risk where the funds invested are not returned.	Close administration and ongoing monitoring of receipts. Award criteria established by service.
Loans to Third Parties – Empty Homes Loan Fund	Small amounts not subject to credit ratings	£150,000 or total funding made available from Scottish Government	Counterparty and market risk where the funds invested are not returned but council has to repay funding to Scottish Government.	A robust procedure is in place for the monitoring and collection of empty homes loans.
West Calder High School DBFMCo Ltd Equity and Subordinated Debt	DBFM company established to provide new West Calder High School by HUB South East Ltd (HUBco) through Schools for the Future Programme	Equity Subscription - £100 Subordinated debt – maximum of 1% of the total eligible cost of construction (£350,000)	This is a service investment which may exhibit market risk. If the DBFM company does not perform and fails to deliver on agreed service objective, the subordinated debt element is at risk.	Shares will not be sold therefore market changes will have no impact. Investment is directly linked to delivery of the new West Calder High School. Ownership is supported by service requirements and must be approved by elected members.

Appendix 4

APPROVED ORGANISATIONS FOR INVESTMENT

	Current Investment Limit £	Investment at 31 Jan 2021 £
Council Bankers		
Lloyds Banking Group (inc Bank of Scotland)	**70,000,000**	64,320,000
WLC Rating Category 1*	**22,000,000**	
No institutions in this category		0
WLC Rating Category 2*	**19,500,000**	
No institutions in this category		0
WLC Rating Category 3*	**17,000,000**	
HSBC Bank plc		0
WLC Rating Category 4*	**14,500,000**	
No institutions in this category		0
WLC Rating Category 5*	**10,000,000**	
No institutions in this category		0
WLC Rating Category 6*	**7,000,000**	
Barclays		0
Goldman Sachs		7,000,000
Nationwide Building Society		0
Santander UK plc		7,000,000
Standard Chartered		0
Sumitomo Mitsui Banking Corporation		7,000,000
Local Authorities, Public Bodies & Debt Management Office**		
Maximum of 20% of total investments	**19,123,020**	
All UK Local Authorities		10,000,000
UK Public Bodies		0
Debt Management Office – Deposit Account		0
Treasury Bills		0
UK Part Nationalised Banks	**35,000,000**	
Royal Bank of Scotland		0
National Westminster		0
Money Market Funds – AAA rated***		
Maximum of 35% of total investments	**33,465,285**	
Aberdeen Liquidity Money Market Fund		0
Other Permitted Investments		
West Calder High School DBFMCo Ltd	**350,000**	295,101
	TOTAL	**95,615,101**

* As rated by the lowest credit rating of the three credit rating agencies Fitch, Moody's and Standard & Poors.

** This limit fluctuates according to total investments. Based on current investments of £95.615 million, the limit would be £19.1 million.

*** This limit fluctuates according to total investments. Based on current investments of £95.615 million, the limit would be £33.5 million.