

PERTH AND KINROSS COUNCIL

28 February 2018

TREASURY ACTIVITY AND COMPLIANCE REPORT – 2017/18 QUARTER 3

Report by the Head of Finance

PURPOSE OF REPORT

The purpose of this report is to provide a summary of Loans Fund transactions for the quarter ending 31st December 2017 and to report on compliance with the Council's Treasury Management Policy Statement (TMPS); Treasury Management Practices (TMPs); the Investment Strategy, and the Prudential indicators for the same period.

1. BACKGROUND / MAIN ISSUES

- 1.1 Treasury Management Practice 6 (TMP 6 - Reporting Requirements & Management Information Arrangements) requires that Loans Fund borrowing and lending activities are reported quarterly to the Council. This report covers the third quarter of the financial year for the period from 1 October to 31 December 2017. TMP 6 also requires that compliance with the approved TMPs, Treasury Policies and Investment Strategy are reported quarterly and this report also covers compliance for the period. The Prudential Indicators are also monitored throughout the year and reported as part of the quarterly Treasury Activity and Compliance report.

2. ECONOMIC BACKGROUND

- 2.1 The Bank of England Monetary Policy Committee (MPC) increased the Bank Rate from 0.25% to 0.50% on 2nd November 2017, whilst there was no change to the quantitative easing (QE) programme at £435bn. This was the first increase in the Bank Rate since July 2007. The factors leading to the increase were inflation remaining above 2% for a prolonged period, the weak value of sterling and low unemployment. However, the MPC also forecast that the economy is unlikely to reach historical growth levels for several years and, therefore, any further increases in the Bank Rate will be small and gradual. There are also uncertainties associated with the implications of Brexit, and its effect on households, businesses and financial markets, which will impact on the economy.
- 2.2 The rate of inflation (Consumer Price Index) fell to 3.0% for the year to December 2017, from 3.1% in the year to November 2017 (which was the highest in 6 years). The increase in November was mainly attributed to increases in air fares and computer games. However, a fall in the price of toys and games contributed to December's reduction. During the quarter, the unemployment rate remained at 4.3%, the lowest level since 1975, however wage growth also remained low, and total earnings rose by only 2.3% and so still below the level of inflation. The real values of earnings, therefore, reduced by 0.4% over the past year. Gross Domestic Product (GDP) economic growth

in the UK was 0.4% for the 3 months to September, which was higher than the previous quarter growth of 0.3%. The increase was mainly attributed to growth in services and manufacturing over the quarter.

- 2.3 Internationally, Eurozone GDP growth remained at 0.6% in the quarter to September 2017 as a result of increased household consumption, fixed investment and exports. Inflation increased to 1.5% by September 2017 as a result of food prices rising. In addition, the EU unemployment rate for the whole economic area reduced to 7.3% by November 2017 from 7.5% in September 2017.
- 2.4 In the US, the Federal Fund Interest Rate was raised to between 1.25% and 1.50% in December 2017, due to the strengthening labour market and strong economic activity. The US unemployment rate fell to 4.1% in November 2017 and remained at that level in December 2017, which was the lowest rate since 2011. The US economy grew by 3.2% on an annual basis to December 2017.
- 2.5 The Public Works Loan Board's (PWLB) Standard fixed interest rates, which are based on yields on UK gilts, are shown in the graph at Appendix I. The rates only moved within a narrow range over the quarter, but were lower at the end of the quarter and remained at around historic lows.

3. TREASURY ACTIVITY

- 3.1 A summary of the Council's treasury position and transactions is shown at Appendix II. The main activities are detailed below.
- 3.2 There were two new fixed rate PWLB maturity loans borrowed in the quarter, totalling £10M. Each loan was borrowed when UK gilt yields fell to around recent low levels, and were required to fund ongoing expenditure on the Capital Programme. Consequently, there were two loans borrowed on the 14th December 2017, each for £5M, with one for a period of 9 years at a rate of 1.96%, and the second for 50 years at a rate of 2.38%.
- 3.3 The Council's total long-term debt increased from £322 million to £332 million over the quarter, whilst the average interest rate on the debt fell from 3.45% to 3.42%. This reduction in the average interest rate equates to savings in interest of £103,500 per annum.
- 3.4 In addition, there were 4 short term market loans borrowed in the quarter. The average amount was £3.6 million, with an average period of 33 days and at an average rate of 0.29%. These were required to cover the cashflow requirements over the Christmas closedown period.
- 3.5 The total amount of short term market borrowing outstanding at 31 December 2017 was £11M, at an average rate of 0.3%. Common Good and Charitable Funds held on fixed deposit within the Loans Fund remained at £2.2M, whilst the average interest rate paid on these funds increased from 0.50% to 0.51%. Funds held from associated bodies and organisations increased over the

quarter from £2.1M to £2.3M, in line with their own cash flow requirements. The average rate paid on these funds remained at 0.10%.

- 3.6 Short term cashflow surpluses were invested in fixed investments, whilst instant access, notice accounts and money market funds were also used for short-term liquidity. The average period for fixed term investments made in the quarter was 291 days, showing an increase from the previous quarter's average period of 134 days, however the level of deposits was lower than the previous period. The average rate achieved in the quarter for fixed investments increased to 0.77% compared to 0.51% in the previous quarter, which reflects the increase in the base rate and the longer lending duration of the deposits.
- 3.7 Most of the investment transactions in the quarter were through the Council's instant access, notice deposit accounts and money market funds, to meet short term daily cashflow liquidity requirements. The level of such investments decreased to an average of £2.9M in the quarter from £4.4M in the last quarter. The average interest rate achieved on these accounts over the quarter increased from 0.25% to 0.35%, reflecting the increase in Bank Rate from November. All of the above investment activities are consistent with the Council's current investment strategy and cashflow requirements.
- 3.8 The total amount of investments outstanding decreased over the quarter, closing at £40.3M compared with £44.8M at the end of the last quarter. This decrease can mostly be attributed to the Council's ongoing expenditure on the Capital programme as well as its expenditure profile over the Christmas period. The overall average rate of interest earned on the investments outstanding at the end of the quarter increased to 0.60% from 0.51%.

4. COMPLIANCE

- 4.1 For the quarter ending 31 December 2017, there were no breaches in compliance with the Council's approved Treasury Management Policy Statement, TMPs or lending limits as detailed in Treasury Management Practice 4 (TMP4) - Approved Instruments, Methods & Techniques.
- 4.2 TMP4 requires that a working list of specific approved counterparties (including lending limits) is maintained by the Head of Finance and continuously updated for any movements in credit ratings, Credit Default Swap (CDS) prices and other factors including press coverage of emerging issues. The Council's Treasury advisor's (Link Asset Services, previously known as Capita Asset Services) suggested maximum lending period for each counterparty is also included within the Council's approved lending policy. Appendix III shows the list of approved counterparties, based on the current lending policy, as at February 2018.
- 4.3 A further requirement of TMP4 is to measure cashflow performance, which is expressed as the average closing cleared bank balance for the period. For the quarter ending 31 December 2017 the average closing cleared bank balance

was £13,124.42 (credit). This is within the set target range of £50,000 (debit or credit).

5. INVESTMENT STRATEGY COMPLIANCE AND PERFORMANCE

- 5.1 The Treasury Investment Strategy for 2017/18 approved by the Council at its meeting on 22 February 2017 (Report No. 17/81 refers) sought to ensure security over principal sums invested, whilst obtaining optimum returns consistent with this approach. Therefore, the only Permitted Investments are in low risk organisations. The limits for each Permitted Investment and individual counterparty ensure a spread of investments, thereby also spreading any risk. The Council also needs to ensure sufficient liquidity at all times to meet its obligations as they fall due and consequently investments must be made in accordance with cashflow requirements. The approved Strategy was based on the assumption that the level of investments would increase in the first half of the year, however, they were not expected to exceed £70,000,000 unless new borrowing was undertaken early in the year.
- 5.2 Following the £10M of PWLB borrowing in the quarter the level of investments peaked at £65.8M on 15 December 2017. By 31 December 2017, the level of investments had decreased to £40.3M. The average daily investment balance over the quarter was £49.4M, which has decreased from the average of £57.6M in the previous quarter, and also decreased from £68.8M in the same quarter of last year. These movements reflect the increase in the Council's expenditure in the current year, particularly within the capital programme, despite the new borrowing undertaken over the year.
- 5.3 The Investment Strategy was applied in full over the quarter with no breaches in compliance with treasury limits, whilst liquidity was maintained by the extensive use of instant access accounts, notice accounts and money market funds as detailed in Section 3 above.
- 5.4 There were no other risks identified nor borrowing in advance of need undertaken in the quarter.
- 5.5 The Investment Strategy also incorporates investments held by the Common Good Funds. All such investments during the quarter were in line with the approved Strategy. The only Council funds held by external fund managers relate to Council administered Charitable Trusts and which are, therefore, not covered by this Investment Strategy.
- 5.6 The Annual Property Investment Strategy for 2017/18 was also approved by the Council at its meeting on the 22 February 2017 (Report No. 17/81 refers) and has been complied with in full, with no breaches in compliance with Permitted Investment limits.
- 5.7 The budgeted income for 2017/18 for Commercial Property investments is £1,738,593, whilst the latest projection for 2017/18 is that actual income will be in line with the budget.

- 5.8 There were neither additional risks identified nor new property investments entered into in the quarter. The Strategy action plan for the rationalisation of the commercial property portfolio remains on programme.

6. PRUDENTIAL INDICATORS

- 6.1 The Council approved its Prudential Indicators for 2017/18 to 2022/23 within the Treasury & Investment Strategy at its meeting on 22 February 2017. These indicators were based on the approved Composite Capital Budget and the Housing Investment Programme.
- 6.2 The latest estimates of the Prudential Indicators are shown at Appendix IV. All indicators of Financing Costs, Capital Expenditure and Financing (borrowing) Requirements continue to increase each year in line with the Council's approved Capital Budget. However, the current estimates of Financing Costs have reduced from the last estimates reported to the Council at its meeting on 20 December 2017 (report 17/412 refers), reflecting the recent debt rescheduling, continued borrowing at low interest rates, and the review of the Loans Fund policies.
- 6.3 All Indicators remain within their current and projected estimates and limits, and accordingly all Prudential Limits were complied with throughout the period. Overall, the Council's plans remain affordable, prudent and sustainable over the medium term.

7. CONCLUSION AND RECOMMENDATIONS

- 7.1 UK GDP grew by 0.4% in the quarter to September 2017, whilst CPI inflation peaked at 3.1% in November 2017 before falling to 3.0% in December 2017. Although unemployment levels showed little change at 4.3%, average earnings still remained below inflation. The Bank of England increased the bank rate on 2nd November 2017 to 0.50%.
- 7.2 Activities during the quarter included new PWLB and short term borrowing, the investment of short term surplus cashflows, consisting of some fixed investments, whilst instant access, notice accounts and money market funds were used to meet short term liquidity requirements. The level of investments decreased over the quarter in line with expectations, despite the new long term borrowing undertaken in the quarter.
- 7.3 The Council adhered to its Investment Strategy and policies throughout the quarter, with no breaches in compliance.
- 7.4 It is recommended that the Council notes the content of this report, which is submitted in accordance with the Council's approved Treasury Management Practices.

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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, Link Asset Services, have been consulted in the preparation of this report.

2. BACKGROUND PAPERS

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

3. APPENDICES

Appendix I – PWLB Fixed Maturity Interest Rates from 1 October to 31 December 2017.

Appendix II – Summary of the Treasury Position and Transactions from 1 October to 31 December 2017.

Appendix III – Approved Investment Counterparty List.

Appendix IV – Monitoring of Prudential Indicators – Quarter-ending 31 December 2017.