PERTH AND KINROSS COUNCIL

25 April 2018

TREASURY ACTIVITY AND COMPLIANCE REPORT – 2017/18 QUARTER 4

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 March 2018 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 fourth quarter of the financial year for the period from 1 January to 31 March 2018. 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) made no change to the Bank Rate at 0.50% or the quantitative easing (QE) programme of £435bn over the quarter. This was despite inflation forecasts remaining at 3% in the short term, reflecting recent higher oil prices and the effects of increased import prices due to sterling's past depreciation. The MPC also forecast that the economy is unlikely to reach historical growth levels for several years. However, they now expect future increases in the Bank Rate to be at a faster pace than they had previously anticipated.

2.2 The rate of inflation (Consumer Price Index) reduced to 2.7% in February 2018, from 3.0% in January 2018. Prices of transportation, recreation and culture services, and food reduced. During the quarter, the unemployment rate decreased to 4.3% for the three months to the end of January from 4.4% in the previous three months. Whilst wage growth grew by 2.6% in January, up from 2.5% in the previous month, this still remained below the rate of inflation. Market commentary suggests that pressure on household income may be reducing with the increase in wage growth and reduction in inflation. Gross Domestic Product (GDP) economic growth in the UK was 0.4% for the quarter to December 2017 which was less than the forecast of 0.5%. This was due to slower growth in the production industries. Household spending grew by 1.8% over the last year, which was the slowest annual rate since 2012, and was attributed to increased consumer prices.

2.3 Internationally, Eurozone GDP growth remained at 0.6% in the quarter to December 2017. This was due to increased exports, fixed investment and household consumption. Inflation decreased to 1.3% in January 2018, and was attributed to lower food and energy costs. In addition, the EU unemployment rate for the whole economic area fell to 7.1% in February 2018, from 7.3% in January 2018.

2.4 In the US, the Federal Fund Interest Rate increased (between 1.50% and 1.75%) in March 2018, in line with expectations. Policymakers advised that gains in employment, household spending, and business fixed investment has strengthened the economic outlook. The US unemployment rate remained at 4.1% in February 2018, whilst the economy grew by 2.9% on an annual basis to December 2017, which was less than the 3.2% in the previous period. However, such economic conditions are expected to result in further gradual increases in the Federal Funds interest rate this year.

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 increased steadily over the quarter, however they did fluctuate giving rise to the opportunity to undertake a debt restructuring exercise and new long term PWLB borrowing.

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. The loans were borrowed when UK gilt yields fell to around recent low levels, and are required to fund ongoing expenditure on the Capital Programme. Consequently, on the 5th March 2018, £12M was borrowed for a period of 50 years at a rate of 2.40%. A further loan of £10M was undertaken on the 26th March 2018 for a period of 50 years at a rate of 2.28%.

3.3 There was also an opportunity to undertake a debt restructuring exercise during the quarter. Two individual loans totalling £6.210m at an average rate of 4.05% were repaid on the 5th February 2018. These were replaced by a single fixed rate loan for £6.1m for 50 years at 2.45% on 8th February 2018. After allowing for redemption premiums, this will generate an estimated saving of £1.7M (£922,000 at Net Present Value) during the life time of the replacement loan and with an average of £35,000 being saved per annum over the next 5 years. There was also the repayment of an instalment of £28,445 on the interest free Salix loan, which was originally borrowed to support investment in energy efficient street lighting.

3.4 The Council's total long-term debt increased from £332 million to £354 million over the quarter, whilst the average interest rate on the debt fell from 3.42% to 3.32%. This reduction in the average interest rate equates to savings in interest of £346,000 per annum.

3.5 There were 5 short term market loans borrowed in the quarter. The average amount was £4.2 million, for an average period of 30 days and at an average rate of 0.38%. These were required to cover the cashflow requirements prior to the drawing down of long term funds. There was no short term market borrowing outstanding at 31 March 2018.

3.6 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 remained at 0.51%. Funds held from associated bodies and organisations increased over the quarter from £2.3M to £2.5M, in line with their own cash flow requirements. The average rate paid on these funds increased to 0.17%.

3.7 Short term cashflow surpluses where invested in fixed investments, whilst instant access, notice accounts and money market funds were used for short-term liquidity. The average period for fixed term investments made in the quarter was 135 days, showing a decrease from the previous quarter's average period of 291 days. The levels of deposits were slightly higher than the previous quarter, but as most were with other local authorities they were for shorter terms. The average rate achieved in the quarter for fixed investments remained at 0.77%, the same as the previous quarter.

3.8 Most of the investment transactions in the quarter were through the Council's instant access, notice deposit accounts and money market funds, in line with short term daily cashflow liquidity requirements. The level of such investments increased to an average of £5M in the quarter from £2.9M in the last quarter, reflecting the Council's cashflow requirements over the quarter. The average interest rate achieved on these accounts over the quarter increased from 0.35% to 0.44%, reflecting the impact of the Base Rate increase in November over the whole quarter. All of the above investment activities are consistent with the Council's current investment strategy and cashflow requirements.

3.9 The total amount of investments outstanding decreased over the quarter, closing at £37.6M compared with £40.3M at the end of the last quarter. This decrease can mainly be attributed to the Council's ongoing expenditure on the Capital programme. The overall average rate of interest earned on the investments outstanding at the end of the quarter increased to 0.73% from 0.60% in the previous quarter.

4. COMPLIANCE

4.1 For the quarter ending 31 March 2018, there were no breaches in compliance with the Council's approved Treasury Management Policy Statement, Treasury Management Practices (TMPs) or lending limits as detailed in 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 reviewed and 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), 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 March 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 March 2018 the average closing cleared bank balance was £11,794.99 in 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) seeks 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 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 £22M of new PWLB borrowing in the quarter, the level of investments peaked at £62.6M on 17 January 2018. By 31 March 2018, the level of investments had decreased to £37.6M. The average daily investment balance over the quarter was £48.2M, which has decreased from the average of £49.4M in the previous quarter, and also decreased from £59M 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 during 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 (report 17/81 refers). 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. The indicator for Financing Costs continues to increase each year in line with the Council's approved Capital Budget. Capital Expenditure and Financing (borrowing) Requirements are also based on the approved Budget.

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 December 2017, whilst CPI inflation reduced to 2.7% in February 2018. Unemployment levels decreased to 4.3%, whilst average earnings still remained below inflation. The Bank of England made no change the bank rate over the quarter.

7.2 Activities during the quarter included a PWLB debt restructuring exercise, a scheduled repayment of the interest free Salix Loan, new long-term PWLB borrowing and short term borrowing. Investment of short term surplus cashflows consisted 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.

Author(s)

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Approved

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ANNEX

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. <u>Corporate Plan</u>

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. <u>Financial</u>

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 January to 31 March 2018.

Appendix II – Summary of the Treasury Position and Transactions from 1 January to 31 March 2018.

Appendix III – Approved Investment Counterparty List.

Appendix IV – Monitoring of Prudential Indicators – Quarter-ending 31 March 2018.