PERTH AND KINROSS COUNCIL

20 December 2017

TREASURY ACTIVITY AND COMPLIANCE REPORT – 2017/18 QUARTER 2

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 30 September 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 second quarter of the financial year for the period from 1 July to 30 September 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) left the Bank Rate at 0.25% over the quarter, and with no change to the quantitative easing (QE) programme at £435bn. However, comments from the MPC after their meeting in September indicated that the Bank Rate would likely be increased in the near future. Subsequently, on the 2nd November 2017, the MPC increased the base rate to 0.50%. 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.

2.2 The rate of inflation (Consumer Price Index) increased over the quarter and reached 3% for the year to September 2017. The increase was mainly attributed to increases in transport and food costs following the decrease in the value of sterling since 2016. During the quarter, the unemployment rate fell to 4.3%, the lowest since 1975, however wage growth remained low, with total earnings rising by only 2.1% which is below the level of inflation. The real value of earnings were down 0.3% over the past year. Gross Domestic Product (GDP) data showed economic growth of 0.4% in the UK for the 3 months to September, which was higher than the previous quarter growth of 0.3%. This was mainly attributed to growth in services and manufacturing increasing during the quarter.

2.3 Internationally, Eurozone GDP growth remained strong at 0.6% in the quarters to June and September 2017. Inflation increased to 1.5% by September 2017 as food prices rose, whilst the cost of services and energy increased at a slower rate. In addition, the EU unemployment rate for the whole economic area reduced to 7.5% by September 2017 from 7.6% in July 2017.

2.4 In the US, the Federal Fund Interest Rate remained between 1.00% and 1.25% in September 2017, but with a further increase still anticipated before the end of the year. The US unemployment rate fell to 4.2% in September 2017, which was the lowest jobless rate since 2011. The US economy grew by 3% on an annual basis to September.

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 fell gradually over the first two months towards historic lows, however from September 2017 they increased as a result of increasing inflation and the anticipated rise in the Base Rate following comments from the MPC. All PWLB rates ended the quarter higher.

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 three new fixed rate PWLB maturity loans borrowed in the quarter, totalling £30M. Each loan was borrowed whilst UK gilt yields remained at historically low levels, and were required to fund expenditure on the Capital Programme as well as refinancing maturing debt. There were two loans borrowed on the 8th August 2017. The first loan was for £5M for a period of 10 years at a rate of 1.98%, and the second loan was for £5M for 50 years at a rate of 2.43%. As rates continued to fall, a third loan was borrowed on the 31st August for £20M for 50 years at a rate of 2.30%.

3.3 The Council has not undertaken any debt restructuring proposals in recent years, as the change to the PWLB premature redemption rates had made the cost of premiums on restructuring too high relative to any potential savings. However, due to the current low long-term PWLB interest rates a review of the portfolio was undertaken. This identified some historic loans at high interest rates which mature within the medium term (average 17 years), where the premiums on the loans were currently more affordable and where debt rescheduling of these loans would generate savings.

3.4 Accordingly, 12 individual PWLB loans totalling £7,919,000 at an average rate of 8.97% and with 17 years on average left to maturity were repaid on the 7th September 2017. This incurred a premium of £8,138,702 which is chargeable over the life of the replacement borrowing. These loans were replaced with one PWLB fixed rate maturity loan for £7,900,000 for 50 years at 2.32% which was borrowed on the 1st September. This will generate an estimated saving to the Council of over £2,000,000 during the life of the replacement loan (at net present value) with £1,470,000 of these savings realised over the next 5 years.

3.5 During the quarter there was also repayment of two maturing fixed rate PWLB loans totalling £8,000,000 with an average rate of 2.86%. In addition, there was also an instalment paid on both the Council's PWLB Equal Instalment of Principal (EIP) loan of £80,645 and the interest free Salix loan of £28,445. There was also one short term market loan of £1,000,000 borrowed in the period at a rate of 0.18% for 7 days.

3.6 As a result of the PWLB debt rescheduling and new PWLB borrowing during the quarter outlined above, the Council's long-term debt increased from £300 million to £322 million, whilst the average interest rate on the debt fell from 3.74% to 3.45%. This reduction in the average rate is equivalent to savings of approximately £933,000 in interest charges per annum in the Council's current portfolio.

3.7 Short term cashflow surpluses where invested in fixed deposits and in line with cashflow requirements, 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 134 days, showing an increase from the previous quarter's average period of 121 days. The average rate achieved in the quarter for fixed investments decreased to 0.51% compared to 0.53% in the previous quarter. The decrease in the rate achieved reflects the current market climate of continuing low interest rates.

3.8 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 increased to an average of £4.4M in the quarter from £3.9M in the last quarter. The average interest rate achieved on these accounts over the quarter also decreased, from 0.32% to 0.25%, reflecting investment rates available. 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 £44.8M compared with £55.45M at the end of the last quarter. This decrease can be attributed to the Councils expenditure on the Capital programme, repayment of maturing debt and the premium paid on the PWLB debt restructuring exercise that was undertaken as outlined in paragraph 3.3 and 3.4 above. The overall average rate of interest earned on the investments outstanding at the end of the quarter decreased to 0.51% from 0.54%.

3.10 Common Good and Charitable Funds held on fixed deposit within the Loans Fund reduced slightly to 2.24M, whilst the average interest rate on these funds decreased from 0.78% to 0.50%. Funds held from associated bodies and organisations increased over the quarter from £1.5M to £2.1M, in line with their own cash flow requirements. The average rate paid on these funds reduced to 0.10% as one temporary loan's balance fell below £1M, and thus attracted a lower rate of interest.

4. COMPLIANCE

4.1 For the quarter ending 30 September 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 (Capita) 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 November 2017.

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 30 September 2017 the average closing cleared bank balance was £10,872.55 (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 £30M of PWLB borrowing in the quarter the level of investments increased and peaked at £70.8M on 6 September 2017. By 30 September 2017, the level of investments had decreased to £44.8M. The average daily investment balance over the quarter was £57.6M, which has increased from the average of £54.7M in the previous quarter, but decreased from £72.5M in the same quarter of last year. These movements reflect the repayment of maturing debt, the premium paid on the debt rescheduling exercise and the increase in the Council's expenditure in the current year, particularly within the capital programme, despite the new borrowing of £30M.

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 new 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 in line with the Council's approved Capital Budget, but remain within their current and projected limits. Accordingly, all Prudential Limits were complied with throughout the period.

6.3 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 rose to 3.0% by September 2017. Although unemployment levels continued to steadily reduce, growth in average earnings remained below inflation. The Bank of England maintained the Bank Rate at 0.25% throughout the quarter, however, they did increase it on 2nd November 2017 to 0.50%.

7.2 Activities during the quarter included a PWLB debt restructuring exercise, repayment of maturing debt and new borrowing from the PWLB. The debt restructuring exercise is estimated to generate overall savings of over £2,000,000 to the Council in borrowing costs, with a large proportion realised within the first five years. The investment of short term surplus cashflows consisted of some investments in fixed deposits, 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.

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

Name	**Designation**	**Date**
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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 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) 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 – PWLB Fixed Maturity Interest Rates from 1 July to 30 September 2017.

Appendix II – Summary of the Treasury Position and Transactions from 1 July to 30 September 2017.

Appendix III – Approved Investment Counterparty List.

Appendix IV – Monitoring of Prudential Indicators – Quarter-ending 30 September 2017.