

# **PERTH AND KINROSS COUNCIL**

**19 December 2018**

## **TREASURY ACTIVITY AND COMPLIANCE REPORT – 2018/19 QUARTER 2**

**Report by Head of Finance (Report No. 18/415)**

### **PURPOSE OF REPORT**

The purpose of this report is to provide a summary of Loans Fund transactions for the quarter ending 30<sup>th</sup> September 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. The report also covers the annual review of the Treasury Management Systems Document.

### **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 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) voted unanimously on 2<sup>nd</sup> August to raise the Bank Rate from 0.50% to 0.75%. This was due to improved economic growth, the strengthening labour market and wage growth over the quarter, which increased future inflationary pressures. There was no change to the quantitative easing (QE) programme of £435bn.
- 2.2 The rate of inflation (Consumer Price Index) reduced to 2.4% in September 2018 from 2.7% in August. This was driven primarily by a drop in food prices. During the quarter, the unemployment rate increased to 4.1% for the three months to the end of September a small increase from 4% in August. Wage growth increased to 3.2% in the 3 months to September from 2.5% in May, and so remained above the rate of Inflation. Gross Domestic Product (GDP) economic growth in the UK increased from 0.4% in the second quarter of the year to 0.6% for the quarter to September 2018, as household spending and exports rose. Retail sales to September 2018 also grew, by 3.0%, mainly attributed to the non food sector. However business investment contracted at the fastest rate since early 2016 in part due to Brexit-related concerns and political uncertainty.

- 2.3 Internationally, Eurozone GDP growth was 0.2% in the quarter to September 2018, and below market expectations. Inflation in the EU increased to 2.1% in September 2018, which was attributed to higher food and energy costs. In addition, the EU unemployment rate for the whole economic area was 6.7% in September 2018, however, this was the lowest rate since January 2000.
- 2.4 In the US, the Federal Fund Interest Rate increased to between 2.00% and 2.25% in September 2018, which was in line with expectations. This rise was due to the strengthening labour market, as well as household spending and business fixed investment growing strongly. The US unemployment rate was 3.8% in September 2018, the lowest since April 2000, whilst the economy grew by 3.5% on an annual basis to September 2018, although this was lower than the previous quarter of 4.2%.
- 2.5 The Public Works Loan Board's (PWLB) Certainty fixed interest rates, which are based on yields on UK gilts, are shown in the graph at Appendix I. The rates increased gradually over the quarter mainly due to interest rate expectations and positive reports on the UK's Brexit negotiations over the summer months.

### **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 Due to the rise in PWLB rates, there was no long term borrowing in the quarter, with the Council taking advantage of short term temporary borrowing to meet cashflow requirements. There was a scheduled repayment of a maturing PWLB fixed rate loan on the 2<sup>nd</sup> July 2018 for £5M. The loan was originally borrowed for 9 years at a rate of 3.57%. In addition, there was also an instalment paid on the Council's interest free Salix loan of £28,445.
- 3.3 Therefore, the Council's total long-term debt decreased from £364 million to £359 million over the quarter, whilst the average interest rate on the debt fell from 3.29% to 3.28%. This reduction in the average interest rate equates to savings in interest of £22,000 per annum.
- 3.4 There were 4 short term market loans borrowed in the quarter. The average amount was £6.25 million, for an average period of 35 days and at an average rate of 0.72%. These were required to cover short-term cashflow requirements. There were two short term market loans outstanding at 30 September 2018, totaling £20M at an average rate of 0.78%.
- 3.5 Common Good and Charitable Funds held on fixed deposit within the Loans Fund remained at around £2.2M, whilst the average interest rate paid on these funds increased from 0.51% to 1.00% reflecting the increase in base rate and reinvestment for longer periods. Funds held from associated bodies and organisations remained at around £2.4M over the quarter, in line with their own cash flow requirements. The average rate paid on these funds remained unchanged at 0.17%.

- 3.6 In line with the Council's approved Investment Strategy and Permitted Investments, short term cashflow surpluses were invested in a mixture of fixed term investments, instant access accounts, notice accounts and money market funds.
- 3.7 For fixed term investments made in the quarter, the average investment period was 132 days, showing a decrease from the previous quarter's average period of 142 days. The level of deposits was slightly higher than the previous quarter, whilst the average rate achieved in the quarter increased to 0.90%, from 0.73% from 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. Therefore, the level of such investments can vary significantly from day to day. However, the daily average over the quarter increased to £4.1M from £3.57M in the last quarter, reflecting the Council's cashflow requirements. The average interest rate achieved on these accounts over the quarter increased from 0.51% to 0.64%, reflecting the impact of the Base Rate increase in August. 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 at the end of the quarter increased, closing at £61M compared with £51.3M at the end of the last quarter. This increase can mainly be attributed to a more positive cashflow at this time of the year. The overall average rate of interest earned on the investments outstanding at the end of the quarter increased to 0.79% from 0.72% in the previous quarter.

#### **4. COMPLIANCE**

- 4.1 For the quarter ending 30 September 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 also 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 November 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 30 September 2018 the average closing cleared bank balance was £12,627.70 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 2018/19 approved by the Council at its meeting on 7 March 2018 (Report No. 18/67 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 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 The level of investments peaked at £72.7M on 19 September 2018. This was a result of £10M PWLB borrowing in the previous quarter and the positive cashflow in the current quarter. The average daily investment balance over the quarter was £56.7M, which has increased from the average of £50.6M in the previous quarter but decreased from £57.6M in the same quarter of last year. These movements reflect the movements in the Council's income and expenditure between quarters, particularly within the Capital programme, and the timing of 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 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 2018/19 was also approved by the Council at its meeting on the 7 March 2018 (Report No. 18/67 refers) and has been complied with in full, with no breaches in compliance with Permitted Investment limits.
- 5.7 The budgeted income for 2018/19 for Commercial Property investments was originally projected to be £1,707,000 and was subsequently increased to £1,717,068. Projections for 2018/19 have been obtained from the Concerto Corporate Property system, which currently forecast that actual income will be £1,867,068, including additional rental income from sub-letting.

- 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 revised Prudential Indicators for 2018/19 to 2027/28 when setting the Composite Capital Budget at its meeting on 20 June 2018 (report 18/212 refers). These indicators were based on the approved ten year Composite Capital Budget, and the five year Housing Investment Programme to 2022/23, including estimates to cover the full ten year period.
- 6.2 The latest estimates of the Prudential Indicators are shown at Appendix IV. The indicator for General Fund Financing Costs reflects a projected gradual increase each year in line with the Council's approved Capital Budgets and interest rate forecasts. Financing Costs for the Housing Investment programme show a similar pattern, and are in line with the phasing of the Housing Investment Programme.
- 6.3 Capital Expenditure and Capital Financing (borrowing) Requirements are also based on the approved budgets, and updated to reflect the latest estimates and amendments approved by the Strategic Policy & Resources Committee on 28 November 2018. The Capital Financing Requirement also rises over the period.
- 6.4 All Indicators remain within their current and projected estimates and/or 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. REVIEW OF THE TREASURY MANAGEMENT SYSTEMS DOCUMENT**

- 7.1 The CIPFA Code of Practice for Treasury Management 2017 ("the Code"), which has been fully adopted by Perth & Kinross Council, requires the Council to prepare 12 Treasury Management Practices (TMPs). The TMPs detail the Council's treasury policies, procedures and guidelines and are required to be reviewed annually. The TMPs and the Treasury Management Policy Statement form part of the Treasury Management Systems Document (TMSD). The approved Treasury Policy also required that the TMSD is reviewed annually and reported to the Council. In previous years, this review was reported separately to the Council, however it has now been incorporated into this Quarterly report for the purpose of expediency and efficiency.
- 7.2 All changes to the Treasury policies approved during the year have been reflected in the revised TMSD. The revised TMSD also reflects the revised Prudential Code issued by CIPFA in December 2017. The only other changes made to the TMSD are minor updates to reflect current operational practices, which have no significant effect on the content of the Systems Document.

- 7.3 The revised TMSD is available on the Councillor's SharePoint site (CHIP). A hard copy is also available upon request from the author of this report.

## 8. CONCLUSION AND RECOMMENDATIONS

- 8.1 UK GDP grew by 0.6% in the quarter to September 2018, whilst CPI inflation reduced to 2.4% from 2.7% in the previous month. Unemployment levels increased to 4.1%, whilst average earnings still remained above inflation for the quarter. The Bank of England's Monetary Policy Committee increased the Bank Rate to 0.75% on the 2nd August 2018.
- 8.2 Activities during the quarter included a scheduled repayment of PWLB and Salix borrowing, as well as 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 increased over the quarter in line with expectations.
- 8.3 The Council adhered to its Investment Strategy and policies throughout the quarter, with no breaches in compliance.
- 8.4 The Treasury Management Systems Document has also been reviewed as discussed in Section 7 of this report.
- 8.5 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
Stewart MacKenzie	Head of Finance	4 December 2018
Jim Valentine	Depute Chief Executive (Chief Operating Officer)	6 December 2018

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## 1. IMPLICATIONS, ASSESSMENTS, CONSULTATION AND COMMUNICATION

<b>Strategic Implications</b>	<b>Yes / None</b>
Community Plan / Single Outcome Agreement	None
Corporate Plan	Yes
<b>Resource Implications</b>	
Financial	Yes
Workforce	Yes
Asset Management (land, property, IST)	Yes
<b>Assessments</b>	
Equality Impact Assessment	Yes
Strategic Environmental Assessment	Yes
Sustainability (community, economic, environmental)	Yes
Legal and Governance	None
Risk	None
<b>Consultation</b>	
Internal	Yes
External	None
<b>Communication</b>	
Communications Plan	None

### 1. Strategic Implications

#### Corporate Plan

- 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.
- 1.2 This report relates to all of these objectives.

## **2. Resource Implications**

### Financial

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

### Workforce

- 2.2 There are no direct workforce implications arising from this report.

### Asset Management (land, property, IT)

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

## **3 Assessments**

### Equality Impact Assessment

- 3.1 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.
- 3.2 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.

### Strategic Environmental Assessment

- 3.3 The Environmental Assessment (Scotland) Act 2005 places a duty on the Council to identify and assess the environmental consequences of its proposals.
- 3.4 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.

### Sustainability

- 3.5 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.
- 3.6 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 July to 30 September 2018.

Appendix II – Summary of the Treasury Position and Transactions from 1 July to 30 September 2018.

Appendix III – Approved Investment Counterparty List.

Appendix IV – Monitoring of Prudential Indicators – Quarter-ending 30 September 2018.