

PERTH AND KINROSS COUNCIL

18 December 2019

TREASURY ACTIVITY AND COMPLIANCE REPORT 2019/20 QUARTER 2

Report by the Head of Finance (Report No. 19/363)

PURPOSE OF REPORT

The purpose of this report is to update the Council on Treasury Activity for the quarter ending 30th September 2019 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 investment 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 2019. 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 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 Base Rate of 0.75% or the quantitative easing (QE) programme of £435bn during the quarter. UK Gross Domestic Product (GDP) contracted by 0.2% in the quarter to June, followed by growth of 0.3% in the quarter to September. Growth in the service sector slowed to its weakest rate in 3 years, and there were also reductions in the production and construction sectors.
- 2.2 During the quarter, UK unemployment remained at around the lowest levels since the 1970's whilst UK CPI inflation fell from 2.1% in July to 1.7% in August and September 2019, and 1.5% in October 2019. At the same time, average earnings continued to grow and remained above the rate of inflation. Retail sales fell in comparison to the previous year, whilst business investment and the housing market also slowed.
- 2.3 Internationally, Eurozone GDP growth was 0.2% in the quarter to June 2019, whilst inflation fell to 1.0% in August 2019 due to a fall in energy costs. EU unemployment was 6.3% in July 2019, which was unchanged from the previous month.

- 2.4 In the US, the Federal Reserve interest rate was reduced to between 1.75% and 2.00% in September. This was the second rate cut this year as inflation remains subdued and with concerns about the economic outlook and ongoing trade tensions with China. The US economy grew by 2.0% annually to June 2019. The forecasts for future growth were also reduced, whilst the global outlook for economic growth remained subdued.
- 2.5 The Public Works Loan Board's (PWLB) Certainty fixed interest rates for the quarter, which are based on yields on UK gilts, are shown in the graph at Appendix I. Uncertainty around Brexit continued with political developments within parliament intensifying which, together with other global economic and political tensions, gave rise to significant volatility in the financial markets. Consequently, there were large movements in the PWLB rates over the quarter. This included rates falling to new historic low points on several occasions over the quarter, with 10 year rates falling as low as 1.13% and 50 year rates falling to 1.57% at the beginning of September.
- 2.6 As a result of increased borrowing activity by local authorities throughout the UK, on the 9 October 2019 the UK Treasury issued amended lending arrangements with immediate effect. From this date, all PWLB borrowing is 1% higher than it was under the previous lending arrangements. Whilst this has had an impact on the Council's estimated borrowing costs and Loan Charges in future years, current PWLB rates are still around their recent average over the last 10 years. Further, any impact on the Council's approved Capital Programme can be contained by the ongoing use of the Capital Fund in the medium term. Alternative lenders are also currently being evaluated, as their own rates may now be more competitive in comparison to the PWLB.

3 CURRENT BORROWING REQUIREMENTS

- 3.1 The Council has a significant need for borrowing over the next few years to fund the approved Capital Programme. The Council's borrowing requirement for the current year is estimated at £85M. The borrowing requirement for next year is £72M, with a further £110M in 2021/22 and £102M in 2022/23. Thereafter, the borrowing requirement averages around £24M over the period of the current Capital programme up to 2028/29.
- 3.2 PWLB rates reduced to unprecedented low levels over the quarter, and remain below recent levels. The table below illustrates the level of rates available during the quarter in comparison to the average rates over the current calendar year and the last 10 years:

PWLB Loan Period	Low Point During Quarter	Average During Quarter	Average in 2018	Average over last 10 years
10 Years	1.13%	1.42%	1.76%	2.78%
50 Years	1.57%	1.89%	2.18%	3.45%

- 3.3 Given the significant borrowing requirement and the unprecedented low interest rates available from the PWLB, the Council undertook extensive borrowing over

the quarter. As detailed at Section 4.2 below, £115M was borrowed in the quarter, at an average rate of 1.79% and average term of 47 years. Total PWLB borrowing for the financial year to date amounts to £130M. This includes £45M which will be applied in funding the 2020/21 Capital programme.

- 3.4 The increased level of borrowing in the current year has increased the estimated interest charges for the current year, however, it has resulted in interest savings in future years. As much of the borrowing was in advance of immediate requirements, the level of investments in the quarter also increased, as detailed in Section 4 below, resulting in increased interest earned. However, with investment returns being below long term borrowing rates, there is a resulting “cost of carry” (ie the difference between borrowing and investment rates).
- 3.5 The cost of carry incurred by the Council by borrowing in advance has been estimated at £715,000 over the next 12 months, however subsequent annual savings in interest charges on the borrowing is estimated at £1.8M per annum, based on forecast PWLB rates for next year when the borrowing is required. Over the 50 year life of the new borrowing, this equates to a net saving of £83M in cash terms (£51M at Net Present Value).
- 3.6 The borrowing activity in the current quarter can be evidenced to be cost effective, and will generate significant savings in interest charges over the next 50 years. This is particularly the case given the change introduced at the start of October 2019 by the PWLB in how they set their interest rates, as described at Section 2.6 above. Further, the low borrowing rates achieved will assist in supporting the Capital Programme over the current budget period.

4. TREASURY ACTIVITY

- 4.1 A summary of the Council's treasury position and transactions is shown at Appendix II. The main activities are detailed below.
- 4.2 As outlined at Section 3.3 above, a total of £115M was borrowed from the PWLB in the quarter, consisting of nine loans at an average interest rate of 1.79% and average term of 47 years. These loans are detailed below:

Date	Amount	Term	Interest
5 July 2019	£10,000,000	50 years	2.01%
29 July 2019	£5,000,000	9.5 years	1.49%
29 July 2019	£5,000,000	50 years	2.03%
6 August 2019	£20,000,000	50 years	1.99%
9 August 2019	£5,000,000	17 years	1.72%
9 August 2019	£20,000,000	50 years	1.84%
19 August 2019	£20,000,000	50 years	1.73%
5 September 2019	£20,000,000	50 years	1.59%
27 September 2019	£10,000,000	50 years	1.62%
Total	£115,000,000	47 years	1.79%

- 4.3 All of the borrowing undertaken during the quarter is required for, and committed to funding, the Council's approved Capital Programme over the next 2 financial years.
- 4.4 There were no PWLB loans maturing in the quarter, however there was one instalment paid of £28,445 on the interest-free loan from Salix Finance. Therefore, the Council's total long-term debt increased by £115M from £399M to £514M over the quarter. The average interest rate on the Council's loan portfolio with the PWLB at the end of the quarter fell from 2.99% to 2.69%, whilst the average interest rate on all long term debt fell from 3.16% to 2.85%.
- 4.5 There was no short term temporary borrowing in the quarter. Common Good and Charitable Funds held on fixed deposit within the Loans Fund remained unchanged at £2.1M and the average interest rate paid on these funds was 1.03%. Funds held from associated bodies and organisations increased to £2.3M over the quarter, in line with their own cash flow requirements, whilst the average rate paid on these funds increased from 0.10% to 0.18%, in accordance with the approved Temporary Loan policy.
- 4.6 As a result of the significant long term borrowing undertaken, including amounts not required until next year, there was also significant investment activity in the quarter. The revised Investment Policy approved by the Council at its meeting on 25 September 2019 (report 19/277 refers) was applied in managing this investment as detailed below.
- 4.7 Consequently, there were significant short term cashflow surpluses which were invested in a mixture of fixed term deposits, instant access accounts, notice accounts and money market funds. All investments were made in accordance with the approved Investment Strategy and Permitted Investments.

Fixed Term Deposits

- 4.8 Cashflow surpluses which arise during the year and which are not immediately required are invested in fixed term deposits for periods up to 12 months. As a result of cashflow requirements and the level of new long term borrowing over the quarter, the number and average amount of fixed deposits undertaken increased significantly. With some of the borrowing in the current quarter being applied to next year's capital programme, many of the fixed deposits were placed for 12 months, both to match the Council's financing requirements and to attract higher investment returns. Consequently, there were 20 fixed deposits made in the quarter, at an average amount of £6.2M, compared to 11 deposits averaging £3.7M in the previous quarter. The average period of the deposits is 325 days, which has increased from 162 days in the previous quarter. The average rate achieved also increased to 1.09% in the quarter (0.96% in the previous quarter), reflecting the longer duration of the deposits.

Investments for Daily Cashflow Requirements

- 4.9 Cashflow surpluses which arise during the year but which are required for more immediate needs, usually within the next 3 months, are invested with the Council's instant access, notice deposit accounts and money market funds. The

daily average amount of such investments held over the quarter increased from £4.4M in the last quarter to £4.7M in the current quarter. The average interest rate achieved on these accounts over the quarter fell from 0.81% to 0.78%. The fall in the interest rate achieved reflects the market rates for short term investments during the quarter which in general reduced.

4.10 All of the above investment activities are consistent with the Council's current investment strategy and cashflow requirements.

4.11 The total amount of investments outstanding at the end of the quarter increased, closing at £184.9M compared to £71.9M at the end of the last quarter. The overall average rate of interest earned on the investments outstanding at the end of the quarter increased to 1.07% from 1.06% in the previous quarter. Total investment income generated over the quarter was £1,333,089, up from the previous quarter of £247,562. The increase in investment income reflects the increase in the number of fixed deposits made in the quarter as described above.

5. COMPLIANCE

5.1 For the quarter ending 30 September 2019, the approved investment limits in place at the time were temporarily exceeded due to the high level of PWLB borrowing and resultant investment activity. All investments were, however, made with low risk Council-approved counterparties. This position was corrected at the earliest opportunity with a revised Lending & Investment Policy submitted to and approved by the Council at its meeting on 25 September 2019 (Report No 19/277 refers). This includes new lending and investment limits based on the relative size of the Council's investment portfolio.

5.2 The increased level of investments has meant that higher levels of deposits have been made by the Council with individual banks. However, these are only with the highest-rated banks with very strong balance sheets, and who have passed all recent stress-tests undertaken by the Bank of England and European Central Bank. Further, whilst the new policy allows up to 40% of investments to be with any individual counterparty meeting the investment criteria, exposure to each has been limited to around 25% to 30% in practice, and with a large level of diversity being maintained within the portfolio to spread any risks, and meet ongoing cashflow requirements. In addition, suggested duration limits have been extended up to 12 months where an individual bank's credit rating is supportive of such a term and any perceived increased risk is negligible.

5.3 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 or 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, where appropriate. Appendix III shows the list of approved counterparties, based on the current lending policy, as at November 2019.

- 5.4 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 2019 the average closing cleared bank balance was £9,725.33 in credit. This is within the set target range of £50,000 (debit or credit).

6. INVESTMENT STRATEGY COMPLIANCE AND PERFORMANCE

- 6.1 The Treasury Investment Strategy for 2019/20 approved by the Council at its meeting on 27 February 2019 (Report No. 19/59 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 £80,000,000 unless new borrowing was undertaken early in the year.
- 6.2 As stated above, the level of investments in the quarter increased significantly and peaked at £195.875M on 18 September 2019. This balance reflects the PWLB borrowing undertaken over the quarter and will reduce over the next 2 years in line with delivery of the Council's Capital Programme. The average daily investment balance over the quarter was £138.1M, which increased from an average of £67.7M in the previous quarter, and increased from £56.7M in the same quarter of last year.
- 6.3 The Investment Strategy was applied in full over the quarter, with liquidity being maintained by the use of instant access accounts, notice accounts and money market funds as detailed in Section 3.8 above. There were no other risks identified in the quarter.
- 6.4 The Investment Strategy also incorporates investments held by the Common Good Funds. All such investments during the quarter were with the Council's Loans Fund, in line with the approved Strategy. The only Council funds held by external fund managers relate to Council administered Charitable Trusts and are, therefore, not covered by this Investment Strategy.
- 6.5 The Annual Property Investment Strategy for 2019/20 was also approved by the Council at its meeting on the 27 February 2019 and has been complied with in full, with no breaches in compliance with Permitted Investment limits.
- 6.6 The budgeted income for 2019/20 for Commercial Property investments was originally projected to be £1,836,000 and has subsequently been increased to £1,922,000. Projections for 2019/20 have been obtained from the Council's Corporate Property system.

- 6.7 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.

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 (TMP'S). The TMPs detail the Council's treasury policies, procedures and guidelines and are required to be reviewed annually. The TMP's and the Treasury Management Policy Statement form part of the Treasury Management Systems Document (TMSD). The approved Treasury Policy also requires that the TMSD is reviewed annually and reported to the Council.
- 7.2 All changes to the Treasury policies approved during the year have been reflected in the revised TMSD. The only other changes made to the TMSD are updates to reflect current operational practices, which have no other 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. PRUDENTIAL INDICATORS

- 8.1 The Council approved Prudential Indicators for 2019/20 to 2028/29 as part of the Treasury & Investment Strategy (Report No. 19/59 refers). These indicators are based on the approved Composite Capital Budget and the Housing Investment Programme.
- 8.2 The latest estimates of the Prudential Indicators, in line with the Council's current approved Capital Budget and Capital Financing (borrowing) Requirements, are shown at Appendix IV.
- 8.3 The indicator for Financing Costs remains at a relatively low level as a result of continuing low interest rates and pro-active treasury management and only fluctuates each year within a narrow range, reflecting a stable budgetary position. However, they are on a gradually increasing trend as interest rates are anticipated to rise over the coming years, and with the estimates now also including the increased interest rates offered by the PWLB. The movements in estimated Capital Expenditure and the Capital Financing Requirement reflect movements on the Composite Capital and Housing Investment programmes approved by the Strategic Policy & Resources Committee.
- 8.4 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.

9. CONCLUSION AND RECOMMENDATIONS

- 9.1 UK GDP grew by 0.3% in the 3 months to September following a 0.2% contraction in the three months to June, whilst CPI inflation fell to 1.5%. Unemployment levels remained low, whilst average earnings remained above inflation for the quarter. The Bank of England's Monetary Policy Committee made no change to the Bank Base Rate of 0.75%. There was significant uncertainty and volatility in the financial markets over the quarter, as Brexit developments and other global economic uncertainties continued, resulting in significant reductions in PWLB interest rates over the quarter.
- 9.2 Activities in the quarter included an increased amount of new long-term PWLB borrowing. Consequently, investment activity also increased significantly, particularly for fixed deposit investments for periods up to 12 months. Overall, these activities will generate significant savings in interest charges in future years. 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.
- 9.3 As a result of the increased level of investment, the Council's revised Lending & Investment Policy was applied over the quarter. The treasury activities throughout the quarter were in line with the Council's approved Investment Strategy.
- 9.4 It is recommended that the Council:
- (i) Notes the content of this report, which is submitted in accordance with the Council's approved Treasury Management Practices,
 - (ii) Notes the annual review of the Treasury Management Systems Document as detailed in Section 7 of this report

Author(s)

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Approved

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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

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 2019.
- Appendix II – Summary of the Treasury Position and Transactions from 1 July to 30 September 2019.
- Appendix III – Approved Investment Counterparty List
- Appendix IV – Monitoring of Prudential Indicators – Quarter-ending 30 September 2019