

PERTH AND KINROSS COUNCIL

27 February 2019

TREASURY ACTIVITY AND COMPLIANCE REPORT – 2018/19 QUARTER 3

Report by the Head of Finance (Report No. 19/58)

PURPOSE OF REPORT

The purpose of this report is to provide a summary of Loans Fund transactions for the quarter ending 31st December 2018 and to report on compliance with the Council's Treasury Management Policy Statement (TMPS); Treasury Management Practices (TMPs); and the Investment Strategy.

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 31st December 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.

2. ECONOMIC BACKGROUND

- 2.1 The Bank of England Monetary Policy Committee (MPC) made no change to the bank rate of 0.75% or the quantitative easing (QE) programme of £435bn during the quarter. The global outlook for economic growth has declined, with increased downside risks to growth. Declining oil prices mean that UK CPI inflation is forecast to fall below 2%. Brexit uncertainties have also intensified, giving added volatility to the UK financial markets. UK equity prices have fallen and Sterling has depreciated further, however they remain subject to continuing volatility. All these factors contributed to the MPC not increasing the bank rate during the quarter.
- 2.2 In the UK the rate of inflation (Consumer Price Index) reduced over the quarter from 2.4% in October to 2.1% in December 2018. During the quarter, unemployment remained near to the lowest levels since the 1970's. At the same time, wages continued to grow and remained above the rate of Inflation. Gross Domestic Product (GDP) economic growth in the UK increased by 0.3% in the three months to November, however this was lower than the 0.4% in the three months to October. Retail sales over the whole quarter fell by 0.2%, therefore putting further pressure on economic growth.

- 2.3 Internationally, Eurozone GDP growth was 0.2% in the quarter to September 2018, whilst inflation fell to 1.6% in December 2018. This was mainly as a result of reduced costs of energy and food. EU unemployment for the whole economic area was 6.7% in November 2018, which was unchanged from the previous month.
- 2.4 In the US, the Federal Reserve increased interest rates to between 2.25% and 2.50% in December 2018. This rise was due to a strong labour market and economic growth. The economy grew by 3.4% on an annual basis over the third quarter, however this was lower than the previous quarter and attributed to reduced personal spending and a reduction in net trade. Economic growth in the US is expected to slow further in 2019, and therefore fewer interest rate rises are projected.
- 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 decreased over the quarter, however they were subject to increased volatility during the period. This was particularly evident around the time of the Brexit debate in Parliament during December.

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 was one long term fixed rate PWLB maturity loan borrowed in the quarter. As a result of the falls in UK gilts yields in December, £10M was borrowed as part of the required funding of the ongoing Capital Programme. The loan was borrowed on 13 December 2018 for a period of 49 years and at an interest rate of 2.38%. In addition, on the 23 October 2018 there was a scheduled repayment of a maturing £5M PWLB fixed rate loan. The loan was originally borrowed for 9.5 years at a rate of 3.31%.
- 3.3 Therefore, the Council's total long-term debt increased by a net £5M from £359M to £364M over the quarter, whilst the average interest rate on the debt fell from 3.28% to 3.26%. This reduction in the average interest rate equates to savings in interest of £73,000 per annum.
- 3.4 The Council made use of short term temporary borrowing to meet cashflow requirements, and there were 3 short term market loans borrowed in the quarter. The average amount was £3.66M, for an average period of 40 days and at an average interest rate of 0.71%. These were required to cover short-term cashflow requirements. There were no short term market loans outstanding at 31 December 2018.
- 3.5 Common Good and Charitable Funds held on fixed deposit within the Loans Fund remained at around £2.1M. The average interest rate paid on these funds increased from 1.00% to 1.02% reflecting the increase in the base rate in the previous quarter and the reinvestment for longer periods. Funds held from associated bodies and organisations reduced to £2.1M over the quarter, in line with their own cash flow requirements. The average rate paid on these funds reduced from 0.17% to 0.10% as the balance on one temporary loan reduced, thus attracting a lower rate of interest.

- 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, due to cashflow requirements over the quarter, the amount of fixed deposits undertaken reduced. However, for the fixed deposits that were undertaken, the average investment period rose to 171 days from the previous quarter's average of 132 days. In addition, the average rate achieved increased to 0.97%, from 0.90% in the previous quarter, reflecting the higher bank rate and longer investment period in the quarter.
- 3.8 In line with the daily cashflow liquidity requirements, most of the investment transactions in the quarter were through the Council's instant access, notice deposit accounts and money market funds. The daily average over the quarter was £5.4M, compared to £4.1M in the last quarter, reflecting the need for increased liquidity in the Council's portfolio. The average interest rate achieved on these accounts over the quarter increased from 0.64% to 0.75%, 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 decreased, closing at £44.4M compared with £61M at the end of the last quarter. This decrease can be attributed to routine expenditure despite the increase in long term debt as outlined in Section 3.3. The overall average rate of interest earned on the investments outstanding at the end of the quarter increased to 0.94% from 0.79% in the previous quarter.

4. COMPLIANCE

- 4.1 For the quarter ending 31 December 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 February 2019.
- 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 2018 the average closing cleared bank balance was £14,845.75 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 £81.5M on 17 October 2018. This peak was a result of several factors, including the mid-month receipt of grant, subsidies and non-domestic rates income, and the short term borrowing undertaken in lieu of requirements later in the month. Consequently, the balance outstanding reduced to £49.5M by 31 October 2018. The average daily investment balance over the quarter was £60.1M, which has increased from the average of £56.7M in the previous quarter and increased from £49.4M in the same quarter of last 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, and the latest forecast remains unchanged from the last quarter at £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 New Prudential Indicators are to be considered under a separate report to this meeting of the Council as part of the Treasury & Investment Strategy and Prudential Indicators 2019/20 to 2028/29 report. This includes an update on the Prudential Indicators for the current year. The new indicators, once approved, will continue to be monitored in the next Quarterly report.

7. CONCLUSION AND RECOMMENDATIONS

- 7.1 UK GDP grew by 0.3% in the three months to November, whilst CPI inflation reduced to 2.1% over the quarter. Unemployment levels remained at 4.1%, whilst average earnings remained above inflation for the quarter. The Bank of England's Monetary Policy Committee made no change to the Bank Rate of 0.75%.
- 7.2 Activities during the quarter included new long-term PWLB borrowing, a scheduled repayment of a PWLB loan, as well as short term borrowing. Investment of short term surplus cashflows consisted of a reduced level of 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.
- 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)

Name	Designation	Contact Details
John Jennings	Senior Accountant	CHXFinance@pkc.gov.uk

Approved

Name	Designation	Date
Stewart MacKenzie	Head of Finance	13 February 2019
Jim Valentine	Depute Chief Executive (Chief Operating Officer)	13 February 2019

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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 October to 31 December 2018.

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

Appendix III – Approved Investment Counterparty List.