

PERTH AND KINROSS COUNCIL

Strategic Policy & Resources Committee

2 February 2022

TREASURY ACTIVITY AND COMPLIANCE REPORT 2021/22 QUARTER 3

Report by the Head of Finance
(Report No. 22/26)

PURPOSE OF REPORT

The purpose of this report is to update the Committee on the Treasury Activity for the quarter ending 31st December 2021 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 investment activities are reported quarterly. This report covers the third quarter of the financial year for the period 1 October to 31 December 2021.

2. ECONOMIC BACKGROUND

- 2.1 The Bank of England's Monetary Policy Committee (MPC) increased the UK Bank Base Rate from 0.10% to 0.25% on 15 December 2021 whilst maintaining the Quantitative Easing programme at £895 billion. The increase in the Bank Base Rate was mainly in response to rising inflation pressures, however it had not been anticipated until early in 2022 due to the continued threat of Covid-19 from the Omicron variant. UK Gross Domestic Product (GDP) increased by 1.1% over the quarter to September 2021.
- 2.2 UK Consumer Price Inflation including housing costs (CPIH) rose to 5.1% in the 12 months to November 2021. It was the highest rate since September 2011, due to rising energy prices and supply chain disruptions. This contributed to the increase in base rate.
- 2.3 Internationally, economic data from both Europe and the US also indicated rising inflation amid continued economic recovery from the pandemic.
- 2.4 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. PWLB borrowing rates showed significant volatility over the quarter and longer-term rates fell steadily with the onset of the Omicron Covid variant causing uncertainty for economic growth. The 50-year long-term borrowing rate fell to a historical low in December 2021. However, with the increase in base rate, inflationary pressures and only limited restrictions introduced by the UK and devolved governments, the longer-term rates increased by the quarter-end but remained lower than at the start of the quarter. The movement in rates was smaller for borrowing of shorter duration, with rates up to 10 years ending the quarter higher than at the start.

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 During the quarter there were 4 new long-term fixed rate PWLB maturity Loans borrowed totalling £90 million and summarised in the following table:

Date	Amount (£)	Interest Rate (%)	Duration (Years)
16 Nov 2021	25,000,000	1.51	50
3 Dec 2021	25,000,000	1.46	49.5
3 Dec 2021	25,000,000	1.46	50
15 Dec 2021	15,000,000	1.26	50

3.3 These loans are required to fund the Capital programme. Whilst there is no requirement for borrowing in the current year, these loans were taken out in the context of an estimated borrowing requirement in excess of £100 million in 2022/23. With PWLB rates reaching historic lows, these loans give estimated savings in interest of £728,000 per annum against forecast interest rates in future years.

3.4 Over the quarter the Council's total long-term debt increased from £528.8 million at an average interest rate of 2.74% to £618.8 million at an average interest rate of 2.55%. There was no requirement for short-term borrowing to manage daily cashflows over the quarter.

3.5 Common Good and Charitable Fund balances held on fixed deposit within the Loans Fund remained at £2.169 million, with the average interest rate paid unchanged at 0.10%. Funds held from associated bodies and organisations decreased from £3.541 million to £3.368 million over the quarter, in line with their own cash flow requirements, whilst the average rate paid on these funds remained at 0.18%, in accordance with the approved Temporary Loan policy.

3.6 Short term cashflow surpluses are 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

3.7 Cashflow surpluses which arise during the year and which are not immediately required are generally invested in fixed term deposits for periods of up to 12 months, or up to 3 years where cashflow requirements allow.

3.8 There were 13 fixed rate deposits made in the quarter for an average amount of £7.3 million at an average interest rate of 0.36% and for an average term of 180 days. Fixed deposit activity increased over the quarter following the PWLB borrowing that was undertaken, whilst interest rates improved with the increase in the bank base rate and the expectation of further increases to follow early in 2023. Subsequently, with the increase in interest rates, fixed deposits for shorter periods (1 to 6 months) are now giving higher returns than many notice accounts.

Investments for Daily Cashflow Requirements

- 3.9 Cashflow surpluses which are required for more immediate needs are invested in the Council's instant access, notice deposit accounts and money market funds. These investment transactions in the quarter can be summarised as follows:
- The daily average amount of such funds over the quarter increased from £9.8million in the last quarter to £10.8 million in the current quarter.
 - The average interest rate achieved on these accounts over the quarter decreased from 0.23% to 0.15%. Instant access facilities were used over the quarter to meet day-to-day cashflow requirements. However, the interest rate on such facilities remains low at 0.01%.
- 3.10 The total amount of investments outstanding at the end of the quarter increased, closing at £260.5 million compared to £203 million at the end of the last quarter. The overall average rate of interest on the investments outstanding reduced from 0.42% at the end of the previous quarter to 0.38% at the end of the current quarter. This reduction reflects the contraction in local authority lending which had previously generated higher returns and the move in the current quarter to fixed deposit activity for shorter periods to allow funds to be reinvested should interest rates rise further.
- 3.11 Total investment income generated on the investments undertaken during the quarter was £356,692 (£74,750 in the quarter ended 30 September 2021). This measure reflects the total return on the investment activity undertaken in each quarter and is significantly higher in the current quarter compared to last quarter as more funds were available to invest.
- 3.12 All of the above investment activities are consistent with the Council's current investment strategy and cashflow requirements.

4. COMPLIANCE

- 4.1 For the quarter ending 31 December 2021, there were no breaches in compliance with the Council's approved Treasury Management Policy Statement, Treasury Management Practices (TMP's) or lending limits as detailed in TMP 4 (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. This list is continuously reviewed and updated for any movements in credit ratings and other relevant factors including press coverage or emerging issues. Appendix III shows the list of approved counterparties, based on the current lending policy, as at January 2022.

- 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 2021 the average closing cleared bank balance was £35,000 in credit.

5. INVESTMENT STRATEGY COMPLIANCE AND PERFORMANCE

- 5.1 The Treasury Investment Strategy for 2021/22 was approved by the Council at its meeting on 31 March 2021 (report 21/42 refers).
- 5.2 In the current quarter the actual level of investments peaked at £294.149 million on 16 December 2021 and reduced to £260.5 million by the end of the quarter. The average daily investment balance over the quarter was £233.232 million, which increased from an average of £203.095 million in the previous quarter and £233.1 million in the same quarter of last year. These variations reflect the new long-term PWLB borrowing in the current quarter.
- 5.3 As the Council has undertaken long-term borrowing of £90 million in the quarter, it is anticipated that the investment balances will increase in the short term before gradually reducing (subject to daily fluctuations) over the next few years as the Capital programme accelerates, and in line with forecast cashflows.
- 5.4 The Investment Strategy was applied in full over the quarter, with liquidity being maintained using instant access accounts, notice accounts and money market funds as detailed in Section 3.9 above. There were no other risks identified in the quarter.
- 5.5 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. The only Council funds held by external fund managers relate to Council administered Charitable Trusts and are, therefore, not covered by this Investment Strategy.
- 5.6 The budgeted income in 2021/22 for Commercial Property investments is £1,819,000 whilst the latest projection for the year is £1,849,000. There were no new property investments entered into during the quarter.

6. PRUDENTIAL INDICATORS

- 6.1 Revised Prudential Indicators for 2020/21 to 2028/29 were approved by the Council at the meeting on 7 October 2020 (report 20/179 refers) as part of the Annual Treasury & Investment Strategy report. These indicators will be reviewed for consideration by elected members as part of the forthcoming update of the Treasury Strategy following approval of the Capital Budget in February.
- 6.2 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.

- 6.3 The indicator for Financing Costs remain at a relatively low level as a result of continuing low interest rates, as well as pro-active treasury management. They also reflect the current estimates for new borrowing each year and the latest forecast for interest rates. As a result, they fluctuate within a relatively narrow range each year, reflecting a stable budgetary position. However, the Council's estimated total Financing Costs are on an increasing trend over the longer term, reflecting the increase in budgeted levels of Capital expenditure funded by borrowing, as well as interest rates being expected to rise over the coming years.
- 6.4 The movements in estimated Capital Expenditure and the Capital Financing Requirement reflect movements on the Composite Capital and Housing Investment programmes approved by the Council. Current estimates have increased following significant slippage during the lockdown restrictions last year carrying over into the current programme. In addition, the Council approved additional borrowing of £35.4 million at its meeting on 6 October 2021 (report 21/181 refers).
- 6.5 As a result of the additional borrowing, it is anticipated that the current borrowing Authorised Limit of £900,000,000 will be breached by 2024/25. In order to deliver the current Capital Programme, this Limit will require to be increased by the Council to around £970,000,000 when considering the Annual Treasury Strategy at its meeting on 9 March 2022. Increasing the Limit at this time would give the Council more flexibility over the timing of new borrowing, for example when interest rates were low or if capital expenditure levels increased in the short-term following the easing of Covid-19 restrictions.

7. CONCLUSION AND RECOMMENDATIONS

- 7.1 The Bank of England's MPC increased the Bank Base Rate to 0.25% in December 2021 in response to rising inflation. PWLB rates for long term borrowing fell to historic low levels in the quarter as the Omicron variant emerged creating uncertainty over economic activity. Consequently, the Council undertook £90 million of PWLB borrowing at an average rate of 1.44% and for an average of 49.9 years. There was no short-term borrowing over the quarter.
- 7.2 Investment activity in the quarter required the use of instant access, notice accounts and money market funds to meet short term liquidity requirements. There was increased use of fixed rate deposits as rates improved and following the PWLB borrowing. Therefore, the total level of investments increased over the quarter.
- 7.3 The Council adhered to its Investment Strategy and policies throughout the quarter, with no breaches in compliance. However, the Council will need to consider increasing the Authorised Limit for borrowing in order to deliver the current Capital Programme.

7.4 It is recommended that the Committee 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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1. IMPLICATIONS, ASSESSMENTS, CONSULTATION AND COMMUNICATION

Strategic Implications	Yes / None
Community Plan / Single Outcome Agreement	None
Corporate Plan	Yes
Resource Implications	
Financial	Yes
Workforce	No
Asset Management (land, property, IST)	No
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 2018 – 2023 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 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 2021.
- Appendix II – Summary of the Treasury Position and Transactions from 1 October to 31 December 2021.
- Appendix III – Approved Investment Counterparty List
- Appendix IV – Monitoring of Prudential Indicators – Quarter ending 31 December 2021