

# **PERTH AND KINROSS COUNCIL**

**3 October 2018**

## **TREASURY ACTIVITY AND COMPLIANCE REPORT – 2018/19 QUARTER 1**

**Report by Head of Finance (Report No. 18/323)**

### **PURPOSE OF REPORT**

The purpose of this report is to provide a summary of Loans Fund transactions for the quarter ending 30 June 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.

### **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 first quarter of the financial year for the period from 1 April to 30 June 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) made no change to the Bank Rate of 0.50% or the quantitative easing (QE) programme of £435bn over the quarter. However, they did vote unanimously, in the following quarter, to raise the bank rate to 0.75% on 2 August 2018. This was due to economic data indicating that the fall in economic growth in the first quarter was only temporary, whilst the labour market continued to improve and wage growth strengthened over the quarter. The MPC reiterated that some further tightening of monetary policy over the next two years will be appropriate to return inflation to the 2% target, however such tightening would only be gradual.
- 2.2 The rate of inflation (Consumer Price Index) reduced to 2.4% in April 2018 from 2.7% in February, and remained at that rate until the end of the quarter. Prices of both transport and housing utilities rose at a faster rate, offset by recreation and culture services, and food & non-alcoholic beverages prices reducing. During the quarter, the unemployment rate decreased to 4.0% for the three months to the end of June from 4.2% in the previous three months. Although wage growth fell to 2.5% in the 3 months to May from 2.6% in

January, this was now above the rate of Inflation. However, this position reversed in June, with wage growth reducing further to 2.4% and inflation increasing to 2.5% in July. Gross Domestic Product (GDP) economic growth in the UK increased from 0.2% in the first quarter of the year to 0.4% for the quarter to June 2018, as household consumption and business investment improved. Retail sales to June 2018 grew by 2.9%, however this was below economic forecasts.

- 2.3 Internationally, Eurozone GDP growth was 0.4% in the quarter to June 2018. Inflation in the EU increased to 2.0% in June 2018, which was attributed to higher food and energy costs, with service's costs rising at a slower rate. In addition, the EU unemployment rate for the whole economic area fell to 6.9% in June 2018, from 7.0% in May 2018.
- 2.4 In the US, the Federal Fund Interest Rate increased to between 1.75% and 2.00% in June 2018, which was in line with expectations. Policymakers advised that gains in employment and economic activity have been rising at a strong rate. There was also growth in household spending and business fixed investment which further strengthened the economic outlook. The US unemployment rate was 4.0% in June 2018, the lowest since April 2000, whilst the economy grew by 4.1% on an annual basis to June 2018, higher than the previous quarter of 2.2%.
- 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 slightly over the first part of the quarter, however they fell sharply at the end of May 2018, due to growing political uncertainties in Europe and the threat of increased trade tariffs. Although the rates subsequently recovered slightly, they remained at a low level over the remainder of the quarter.

### **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 new fixed rate PWLB maturity loan borrowed in the quarter. The loan was borrowed when UK gilt yields fell sharply at the end of May to around recent low levels, and was required to fund ongoing expenditure on the Capital Programme. Consequently, on the 31 May 2018, £10M was borrowed for a period of 50 years at a rate of 2.25%.
- 3.3 The Council's total long-term debt increased from £354 million to £364 million over the quarter, whilst the average interest rate on the debt fell from 3.32% to 3.29%. This reduction in the average interest rate equates to savings in interest of £113,000 per annum.
- 3.4 There were 2 short term market loans borrowed in the quarter. The average amount was £3.5 million, for an average period of 19 days and at an average rate of 0.43%. These were required to cover short-term cashflow

requirements. There was one short term market loan outstanding at 30 June 2018, for £1M at 0.45%.

- 3.5 Common Good and Charitable Funds held on fixed deposit within the Loans Fund remained at £2.2M, whilst the average interest rate paid on these funds remained at 0.51%. Funds held from associated bodies and organisations reduced over the quarter from £2.5M to £2.4M, in line with their own cash flow requirements. The average rate paid on these funds remained unchanged at 0.17%.
- 3.6 Short term cashflow surpluses were invested in fixed term investments, instant access, notice accounts and money market funds. The average period for fixed term investments made in the quarter was 142 days, showing an increase from the previous quarter's average period of 135 days. The level of deposits was higher than the previous quarter, however the average rate achieved in the quarter reduced to 0.73%, from 0.77% from the previous quarter.
- 3.7 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. The level of such investments reduced to a daily average of £3.57M over the quarter from £5M in the last quarter, reflecting the Council's cashflow requirements over the quarter. The average interest rate achieved on these accounts over the quarter increased from 0.44% to 0.51%, reflecting the impact of the predicted Base Rate increase in August over the whole quarter. All of the above investment activities are consistent with the Council's current investment strategy and cashflow requirements.
- 3.8 The total amount of investments outstanding increased over the quarter, closing at £51.3M compared with £37.6M at the end of the last quarter. This increase can mainly be attributed to the new borrowing that was undertaken in the quarter and the positive cashflow from the start of the financial year. The overall average rate of interest earned on the investments outstanding at the end of the quarter decreased to 0.72% from 0.73% in the previous quarter.

#### **4. COMPLIANCE**

- 4.1 For the quarter ending 30 June 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 August 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 June 2018 the average closing cleared bank balance was £19,229.08 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 Following the £10M of new PWLB borrowing in the quarter, the level of investments peaked at £66.5M on 20 June 2018. By 30 June 2018, the level of investments had decreased to £51.3M. The average daily investment balance over the quarter was £50.6M, which has increased from the average of £48.2M in the previous quarter but decreased from £54.68M 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 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 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, however, they are at a lower level following the extension of Capital Expenditure (Loans Fund Advances) repayment periods. Financing Costs for the Housing Investment programme show only small variations over the ten year period.
- 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 12 September 2018.
- 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. CONCLUSION AND RECOMMENDATIONS**

- 7.1 UK GDP grew by 0.4% in the quarter to June 2018, whilst CPI inflation reduced to 2.4% in April 2018 and remained at that level over the quarter. Unemployment levels decreased to 4.2%, whilst average earnings still remained slightly above inflation for the quarter. The Bank of England's Monetary Policy Committee made no change to the bank rate over the quarter, however they did increase it to 0.75% on the 2nd August 2018.
- 7.2 Activities during the quarter included new long-term PWLB borrowing and 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.

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.

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#### Approved

Name	Designation	Date
Stewart MacKenzie	Head of Finance	29 August 2018
Jim Valentine	Depute Chief Executive (Chief Operating Officer)	5 September 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 April to 1 July 2018.

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

Appendix III – Approved Investment Counterparty List.

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