

PERTH AND KINROSS COUNCIL

25 September 2019

TREASURY ACTIVITY AND COMPLIANCE REPORT 2019/20 QUARTER 1

Report by Head of Finance (Report No. 19/277)

PURPOSE OF REPORT

The purpose of this report is to update the Council on the Treasury Activity for the quarter ending 30th June 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 seeks the approval of proposed amendments to the Lending and Investment Policy.

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 first quarter of the financial year for the period from 1 April to 30 June 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, following 0.5% growth in the previous quarter. The contraction was attributed to the running down of stocks which had been built up prior to the original EU departure date of 29 March 2019. A slow down in car production in the quarter also contributed to reduced growth, as manufacturers shut down operations during April in anticipation of departing from the EU. Brexit uncertainties and the Conservative party leadership contest contributed to volatility in the UK financial markets during the quarter.
- 2.2 During the quarter, UK unemployment remained around the lowest levels since the 1970's whilst UK CPI inflation remained at 2% in June 2019, unchanged from the previous month. At the same time, average earnings continued to grow and remained above the rate of inflation. Retail sales remained higher than the previous year, whilst business investment and the housing market grew, though at subdued levels.

- 2.3 Internationally, Eurozone GDP growth was 0.2% in the quarter to June 2019, whilst inflation fell to 1.3% in June 2019 due to reduced energy costs. EU unemployment was 6.3% in June 2019, which was unchanged from the previous month.
- 2.4 In the US, Federal Reserve interest rates remained between 2.25% and 2.50% over the quarter. However, they were subsequently cut to 2% and 2.25% at the July meeting of the Federal Reserve, due to low inflation and reduced economic growth. In addition, the US economy was impacted by other issues, including trade disputes with China and Europe. The US economy grew by 2.1% annually to June 2019, which was lower than the previous quarter's equivalent growth rate of 2.6%. 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 the Brexit negotiations continued, before the date for leaving the EU was extended to 31 October 2019, whilst political developments within parliament intensified. These factors increased volatility throughout the quarter. Consequently, rates rose over the first part of the quarter, before generally falling steadily towards the end of the quarter. It should also be noted that rates fell significantly in the first week of July.

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 were three long-term fixed-rate PWLB loans borrowed in the quarter. Following volatility in PWLB borrowing rates over the quarter, £15M was borrowed as part of the required funding of the ongoing Capital Programme. The first loan of £5M was borrowed on 3 April 2019 for a period of 9.5 years and at an interest rate of 1.80%. A second PWLB loan of £5M was borrowed on 31 May 2019 for 50 years at a rate of 2.19%. On 26 June 2019 a third PWLB loan of £5M was borrowed for 50 years at a rate of 2.11%.
- 3.3 There were no PWLB loans maturing in the quarter. Therefore, the Council's total long-term debt increased by £15M from £384M to £399M over the quarter. The average rate on the Council's loan portfolio with the PWLB at the end of the quarter fell to 2.99%, whilst the average interest rate on all long term debt fell from 3.20% to 3.16%. This reduction in the average interest rate equates to savings in interest of £168k per annum, if the original rate were to be applied to the portfolio at 30 June 2019.
- 3.4 The Council made use of short term temporary borrowing early in the quarter to meet cashflow requirements, with one short term market loan of £5M borrowed for a period of 29 days and at an interest rate of 0.68%. This was required to cover short-term cashflow requirements during April. There were no short term market loans outstanding at 30 June 2019.

- 3.5 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 remained at 1.04%. Funds held from associated bodies and organisations decreased to £2.1M over the quarter, in line with their own cash flow requirements. The average rate paid on these funds decreased from 0.18% to 0.10%, in accordance with the approved temporary loan policy.
- 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 deposits, instant access accounts, notice accounts and money market funds.

Fixed Term Deposits

- 3.7 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 new long term borrowing over the quarter, the number and average amount of fixed deposits undertaken increased. However, the average investment period decreased from 196 days in the previous quarter to 162 days in this quarter. In addition, the average rate achieved decreased to 0.96%, from 1.05% in the previous quarter, reflecting the shorter duration of the deposits.

Investments for Daily Cashflow Requirements

- 3.8 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 £4.1M in the last quarter to £4.4M, reflecting the Council's positive cashflow at the start of the new financial year. The average interest rate achieved on these accounts over the quarter increased from 0.79% to 0.81%. 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 £71.9M compared to £50.8M 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 1.06% from 1.01% in the previous quarter. Total investment income generated over the quarter was £247,562, up from the previous quarter of £212,813. The increase in investment income reflects the increased number of fixed deposits made in the quarter and higher Money Market Fund balances and returns.

4. COMPLIANCE

- 4.1 For the quarter ending 30 June 2019, 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 September 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 30 June 2019 the average closing cleared bank balance was £17,895.48 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 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.
- 5.2 The level of investments in the quarter peaked at £87.4M on 26 June 2019. This peak coincided with new PWLB long term borrowing which was undertaken at this time. The balance outstanding subsequently reduced to £71.9M by 30th June 2019. The average daily investment balance over the quarter was £67.7M, which increased from the average of £56.3M in the previous quarter, and increased from £50.8M in the same quarter of last year. This increase reflects the new PWLB borrowing over the quarter and the Council's cashflow at this time of 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. There were no other risks identified, nor borrowing in advance of need undertaken, in the quarter.
- 5.4 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.

- 5.5 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.
- 5.6 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.
- 5.7 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.

6. REVIEW OF THE APPROVED LENDING & INVESTMENT POLICY.

- 6.1 The approved Lending & Investment policy covers the Council's:
- Permitted Investments,
 - Definition of Approved Organisations for Investment, and
 - Lending & Investment Categories & Limits.
- 6.2 The Council's Permitted Investments are approved annually by the Council as part of the Annual Treasury & Investment Strategy, and the current Permitted Investments were approved on 27 February 2019 (report 19/59 refers). Therefore, no changes to these are proposed at this time.
- 6.3 However, the Definition of Approved Organisations for Investment and Lending & Investment Categories & Limits have not been reviewed for a number of years. These elements of the Treasury Policy have now been reviewed, and the revised Treasury Policy proposed is shown at Appendix IV.
- 6.4 There are no substantive changes proposed to the Definition of Approved Organisations for Investment, with the changes being merely to clarify and simplify how individual counterparties are selected for investment. However, in the context of resourcing the Council's £700M of approved capital expenditure over the coming years it has proved necessary to undertake a more comprehensive review of the Investment Categories & Limits due to the limitations in applying the current policy at higher investment balances.
- 6.5 The current approved policy ensures that investments are placed with a wide range of counterparties and therefore not concentrated in a small number of banks. However, once deposits with the top-rated banks have reached their limit, as the level of deposits increases beyond this level, the policy requires that deposits are placed with less strong counterparties or counterparties paying significantly lower returns. As the individual limits are historic and were set relative to the overall estimated investment portfolio at that point in time, as the size of the portfolio increases, the policy places undue restrictions on depositing with the top-rated banks, as well as potentially leaving the Council unable to take advantage of more attractive investment opportunities.

6.6 Given the current period of exceptionally low long term interest rates available with the PWLB, it is anticipated that the Council will undertake a significant amount of borrowing in the current year. This is in line with the approved Treasury Strategy, where the Council will consider accelerating its borrowing should interest rates fall to low levels. However, as a consequence of this, the level of investment balances held by the Council in the short-term is anticipated to increase significantly.

6.7 Accordingly, it is proposed that Counterparty Limits for each individual bank and institution are based on percentages of the total investment portfolio, but with a lower limit based on monetary amount. This would ensure that individual limits would rise and fall in line with the overall level of investments, and also ensure a spread of investments amongst different banks as apt of managing investment risk.

6.8 In consultation with Link Asset Services, the Council's Treasury Management advisors, the counterparty limits have been reviewed. The proposed revised limits are shown at Appendix IV and can be summarised as follows:

- Category 1 Principal UK Banks – 40% or £20M per individual counterparty, whichever is larger.
- Category 2 Foreign Banks & Institutions – 25% or £10M per individual counterparty, whichever is larger.
- Category 3 UK Subsidiary Banks & Building Societies – 15% or £10M per individual counterparty, whichever is larger.
- Category 4 Other Local Authorities – 20% or £20M per individual counterparty, whichever is larger.
- Category 5 Money Market Funds – 10% or £10M per individual Fund, whichever is larger.

6.9 Comparison of the proposed limits with the previously approved limits for individual counterparties can be illustrated as follows:

	Previously Approved Limit	Proposed Limit (the larger of)
Category 1 – Principal UK Banks	£20M	40% or £20M
Category 2 – Foreign Banks & Institutions	£10M	25% or £10M
Category 3 – UK Subsidiary Banks and Building Societies	£5M	15% or £10M
Category 4 – Other Local Authorities	£10M	20% or £20M
Category 5 – Money Market Funds	£10M	10% or £10M

6.10 The proposed percentage limits are based on ensuring a reasonable spread of investments and risk, whilst favouring UK banks, and without being unduly restrictive. The monetary limits are broadly in line with the current approved policy, and ensure that an adequate limit is always available for immediate access and liquidity purposes. Taken together, the above limits would allow the proposed policy to operate at both high and low levels of investments, and would ensure an adequate spread of investments in higher quality

organisations, maintaining the Council's prudent approach to managing investment risk.

7. PRUDENTIAL INDICATORS

- 7.1 The Council approved its Prudential Indicators for 2019/20 to 2028/29 within the Treasury & Investment Strategy at its meeting on 27 February 2019 (Report No. 19/59 refers). These indicators were based on the approved Composite Capital Budget and the Housing Investment Programme.
- 7.2 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 V.
- 7.3 The indicator for Financing Costs remain 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. The increase in Capital expenditure and the Capital Financing Requirement for the period mostly relates to amounts brought forward from 2018/19, together with movements in the current approved programme.
- 7.4 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.

8. CONCLUSION AND RECOMMENDATIONS

- 8.1 UK GDP contracted by 0.2% in the three months to June, whilst CPI inflation remained static over the quarter at 2%. 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 continued uncertainty and volatility in the financial markets over the quarter, as Brexit developments continued, resulting in UK Gilt yields fluctuating over the quarter.
- 8.2 Activities in the quarter included new long-term PWLB borrowing and short term borrowing. Investment of short term surplus cashflows consisted of an increased 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 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. A revised Lending and Investment Policy is proposed at Section 6.
- 8.4 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) Approves the revised Approved Lending and Investment Policy, as detailed at Section 6 and shown at Appendix IV to this report.

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Approved

Name	Designation	Date
Stewart MacKenzie	Head of Finance	
Jim Valentine	Depute Chief Executive (Chief Operating Officer)	11 September 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 April to 1 July 2019.
- Appendix II – Summary of the Treasury Position and Transactions from 1 April to 30 June 2019.
- Appendix III – Approved Investment Counterparty List
- Appendix IV – Revised Lending & Investment Policy
- Appendix V – Monitoring of Prudential Indicators – Quarter-ending 30 June 2019