REPORT TO: POLICY AND RESOURCES COMMITTEE ON 2 OCTOBER 2018

SUBJECT: REPORT ON TREASURY MANAGEMENT PERFORMANCE AND TREASURY AND CAPITAL INVESTMENT PRUDENTIAL INDICATORS FOR 2017/18

BY: CORPORATE DIRECTOR (CORPORATE SERVICES)

1. REASON FOR REPORT

1.1 To provide Council with the annual outturn report on Treasury Management and details of the Council's Prudential Indicators for Treasury Management and Capital Investment for the year ended 31 March 2018.

1.2 This report is submitted to Council in terms of Sections III B (3) of the Council's Scheme of Administration relating to Treasury Management and the Capital Plan.

2. RECOMMENDATION

2.1 It is recommended that the Council consider the Treasury Management Performance as set out in Section 4 of this report and the Council's Treasury Management and Capital Investment Prudential Indicators for 2017/18 as set out in the attached APPENDIX.

3. BACKGROUND

3.1 Members have agreed that reports on Treasury Management Performance are submitted twice annually. One report to agree the Treasury Management and Investment Strategies with relevant Performance Indicators and the second report to submit the annual review and actual performance of Treasury Management activities. Quarterly Treasury Management monitoring reports are posted on the Members Portal during the year.

3.2 The Local Government (Scotland) Act 2003 (the Act) and supporting regulations requires the council to adhere to the CIPFA Treasury Management Code of Practice and adopt the CIPFA Prudential Code for Capital Finance in Local Authorities and to produce the prudential indicators set out in the Prudential Code. These indicators are designed to support and record affordable and sustainable capital investment and treasury management.

3.3 The primary requirements of the Code are as follows:

- An approved Treasury Management Policy, which sets out the policies and objectives of the council's treasury management activities.

- Approved Treasury Management Practices, which set out the manner in which the council will seek to achieve those policies and objectives.

- An annual treasury management strategy report to council for the year ahead and an annual review report to council of the previous year.

3.4 CIPFA published revised editions of the Treasury Management and Prudential Codes in December 2017. The required changes from the 2011 Codes are being incorporated into Treasury Management strategies and monitoring reports.

3.5 As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3 January 2018 local authorities were automatically treated as retail clients but could "opt up" to professional client status, providing certain criteria was met. The Council has met the conditions to opt up to professional status and has done so in order to maintain its previous MiFID II status prior to January 2018. This means the Council will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

4. TREASURY PERFORMANCE 2017/18

4.1 This annual Treasury Management performance report covers

- The Economy and Interest Rates in 2017/18
- Treasury Management Strategy for 2017/18
- Annual Investment Strategy 2017/18
- Investment Outturn for 2017/18
- Long Term Borrowing and Debt Rescheduling
- Short Term Borrowing
- Prudential Indicators

4.2 The Economy and Interest Rates 2017/18

4.2.1 Key influences in 2017/18 were: expectations of tapering of Quantitative Easing; the potential for increased interest rates in the United States and Europe and geopolitical tensions.

4.2.2 The UK economy showed signs of slowing with latest estimates showing that Gross Domestic Product grew by 1.8% in the 2017 calendar year, the same level as the 2016 calendar year. This was a far better outcome than the majority of forecasts following the EU Referendum in June 2016, but it also reflected the international growth momentum generated by the increasingly buoyant US economy and the re-emergence of the Eurozone economies.

4.2.3 The inflationary impact of rising import prices, a consequence of the fall in sterling associated with the EU referendum outcome, resulted in year-on-year Consumer Price Inflation rising to 3.1% in November 2017 before falling back to 2.7% in February 2018. Real average earnings growth turned negative before slowly recovering. The labour market showed resilience as the unemployment rate fell back to 4.3% in January 2018. The inherent weakness in UK business investment was not helped by political uncertainty following the surprise General Election in June 2017 and by the lack of clarity on Brexit.

4.2.4 The Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 0.25% in November 2017. It was significant in that it was the first rate increase in ten years, although in essence the MPC reversed its August 2016 cut following the referendum result. The February Inflation Report indicated the MPC was keen to return inflation to the 2% target over a more conventional horizon (18-24 months) with "gradual" and "limited" policy tightening. Although in March two MPC members voted to increase rates immediately, the MPC as a whole stopped short of committing itself to the timing of the next increase in rates. The increase in Bank Rate resulted in higher money market rates.

4.3 2017/18 Treasury Management Strategy

4.3.1 The Council's Treasury Management Strategy for 2017/18 incorporating the Annual Investment Strategy, was approved by the Council at its meeting on 15 February 2017 (Paragraph 7 of the Minute refers).

4.3.2 The Council's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required.

4.3.3 Affordability and the "cost of carry" remained important influences on the Council's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested at rates of interest significantly lower than the cost of borrowing. As short-term interest rates have remained and are likely to remain for the foreseeable future, lower than long-term rates, it was more cost effective to mainly utilise internal borrowing and borrow short dated loans from other local authorities.

4.3.4 The Public Works Loan Board (PWLB) is the Council's preferred source of long-term borrowing given the transparency and control that its facilities continue to provide.

4.4 Annual Investment Strategy

4.4.1 Security of capital remains the Council's main investment objective followed by liquidity. In the current economic climate it is considered to be prudent to keep investments short term and only invest with highly credited UK financial institutions who have a long-term credit rating of BBB+ or higher. An optimum return is sought within those parameters.

4.4.2 The Council's creditworthiness policy is set in accordance with credit rating criteria discussed and agreed with the Council's treasury advisers. The Head of Financial Services maintains a counterparty list in compliance with the criteria and revises the criteria and submits to Council for approval as necessary.

4.4.3 All credit ratings are monitored daily and the Counterparty List is amended to reflect any changes.

4.5 Investment Outturn for 2017/18

4.5.1 The Council manages its investments in-house and invests with the institutions listed on the Council's approved Counterparty list.

4.5.2 The table below shows the overall investment undertaken by the Council during 2017/18.

	Total Sum Deposited (£m)	Average Rate (%)
Approved Financial Institutions	54.930	0.29
Council's Bankers	189.985	0.29
TOTAL	244.915	0.29

The above figures are cumulative and the actual amounts invested at any one time ranged from 0.65 million to £24.31 million.

4.5.3 The average rate of interest earned on investments during the year was 0.29%, compared to the average 7 day London Inter Bank Bid Rate (LIBID) of 0.31%.

4.5.4 As at 31 March 2018, the following balance was invested:

Counterparty	Investment	Amount (£m)	Interest Rate (%)
Bank of Scotland	Call Account	2.56	0.40
Standard Life	Money Market Fund	5.0	0.46
Blackrock	Money Market Fund	5.0	0.39
Insight	Money Market Fund	1.0	0.39
	Total	13.56	0.42

4.6 Long Term Borrowing and Debt Rescheduling

4.6.1 The Council's long term external debt position at 31 March 2018 compared with the position at the end of the last financial year was as follows: -

	31 March 2017			31 March 2018		
	Actual (£000)	Rate (%)	Average Life (Years)	Actual (£000)	Rate (%)	Average Life (Years)
Fixed Rate Funding – PWLB Fixed Rate Funding – Market	126,169 33,600	5.32 4.65	20.99 56.82	127,128 34,075	5.26 4.61	20.01 55.65
Variable Rate Funding - PWLB Variable Rate Funding - Market	- -	- -	- -	- -	- -	- -
Total Debt	159,769	5.18		161,203	5.12	

4.6.2 The Council has been maintaining an under borrowed position which means that the capital borrowing need (Capital Finance Requirement) has not been fully funded with loan debt. Cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure to offset the need to borrow.

4.6.3 The strategy of effectively delaying new long-term borrowing by utilising internal and temporary borrowing has served well at a time when comparatively cheaper temporary borrowing from other local authorities is readily available, counterparties meeting the Council's investment criteria are limited, and historically low investment returns give rise to potentially significant carrying costs for new long-term borrowing.

4.6.4 To avoid having too large a percentage of short-term debt ie repayable in less than 12 months, compared to the overall debt portfolio, advantage was taken of historically low interest rates to borrow £5 million from the Public Loans Board (PWLB) at 1.19% for 10 years. The loan will be repaid by equal annual instalments (EIP) over the period of the loan.

4.6.5 No debt rescheduling was undertaken during the year as the average 1% differential between PWLB new borrowing rates and PWLB premature repayment rates continue to make rescheduling unviable.

4.7 <u>Short Term Borrowing</u>

4.7.1 During the year, forty new temporary loans totalling £79 million were borrowed from other UK local authorities. The following short term loans were outstanding at 31 March 2018:-

Organisation	Maturity Date	Borrowing Rate (%)	Amount £m
Middleborough Council	5-Apr-18	0.47	2.00
Chesterfield Borough Council	16-Apr-18	0.50	3.00
Cumbria Police & Crime Commissioner	30-Apr-18	0.50	2.00
Broxbourne Borough Council	1-May-18	0.46	1.00
Aberdeen City Council	29-May-18	0.46	2.00
Chichester District Council	1-Jun-18	0.50	1.00
Blaby District Council	1-Jun-18	0.75	1.00
Wakefield Metropolitan District Council	4-Jun-18	0.57	2.00
Northern Ireland Housing Executive	22-Jun-18	0.55	2.00
Bedford Borough Council	27-Jun-18	0.85	2.50
Aberdeen City Council	9-Jul-18	0.55	2.00
Angus Council	23-Jul-18	0.55	2.00
Orkney Islands Council	30-Jul-18	0.60	2.00
Western Isles	31-Jul-18	0.42	5.00
East Renfrewshire Council	23-Aug-18	0.75	2.00
Kings Lynn & West Norfolk Borough Council	23-Aug-18	0.75	2.00
East Renfrewshire Council	31-Aug-18	0.75	1.00
Edinburgh City Council	10-Sep-18	0.85	4.00
Tendring District Council.	20-Sep-18	0.75	1.00
Durham County Council	21-Sep-18	0.90	3.00
Barrow Borough Council	28-Sep-18	0.80	2.00
North West Leicestershire District Council	14-Dec-18	0.82	2.50
		0.64	47.00

4.8 Prudential Indicators

4.8.1 The Prudential Indicators for 2017/18 were approved by the Full Council on 15 February 2017 (paragraph 7 of the minute refers). There were no breaches of these indicators during 2017/18. Performance against key indicators is shown in the **APPENDIX 1.**

5. SUMMARY OF IMPLICATIONS

(a) Corporate Plan and 10 Year Plan (Local Outcomes Improvement Plan (LOIP))
None arising specifically from this report.

(b) Policy and Legal
The Local Government in Scotland Act 2003 provides the powers to borrow and invest as well as providing controls and limits on these activities.

The Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector which details best practice The Local Government Investment (Scotland) Regulations 2010.

All Treasury Management activities are carried out in accordance with this Code and Regulations.

(c) Financial implications
The net cost of Treasury Management activities has a significant effect on the Council's overall finances. All financial considerations are contained within the body of the report and the attached **APPENDIX 1.**

(d) Risk Implications
The Council is aware of the risks of passive management of the treasury portfolio and, with the support of the Council's treasury advisers, will proactively manage its investments and debt over the year.

There is little risk of volatility of costs in the current debt portfolio as the interest rates are predominantly at fixed, long term levels. Shorter term variable rates and the likely future movements in these variable rates predominantly determine the Council's investment and borrowing strategies.

Capital expenditure is closely monitored and Budget Managers are aware of their responsibilities to manage budget allocations.

(e) Staffing Implications
None arising specifically from this report.

(f) Property
None arising specifically from this report.

(b) Equalities/Socio Economic Impact
None arising specifically from this report.

(g) Consultations

This report has been produced in consultation with Arlingclose Limited, the Council's Treasury Advisers.

6. CONCLUSION

6.1 The Council's requirement for funds continues to be managed in accordance with the agreed Treasury Management Strategy Statement. All treasury management and capital investment activities have been undertaken with the limits set by the Prudential Code Performance Indicators for 2017/18.

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Background Papers: Various working papers held within Financial Services
Ref: AB/DMcL/