REPORT TO: POLICY AND RESOURCES COMMITTEE ON 3 SEPTEMBER 2019

SUBJECT: REPORT ON TREASURY MANAGEMENT PERFORMANCE AND TREASURY AND CAPITAL INVESTMENT PRUDENTIAL INDICATORS FOR 2018/19

BY: CORPORATE DIRECTOR (CORPORATE SERVICES)

1. REASON FOR REPORT

1.1 To provide Committee 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 2019.

1.2 This report is submitted to Committee 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 Committee consider and note the Treasury Management Performance and the Council's Treasury Management and Capital Investment Prudential Indicators for 2018/19 as set out in the attached APPENDIX 2.

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 throughout the year.

3.2 The Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Sector 2017 (the Code) and the Local Government Investment (Scotland) Regulations 2010. All treasury management activities are carried out in accordance with the Code and regulations.

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 The Local Government (Scotland) Act 2003 requires the council to 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.

4. TREASURY PERFORMANCE 2018/19

4.1 This annual Treasury Management performance report covers

- The Economy and Interest Rates in 2018/19
- Treasury Management Strategy for 2018/19
- Annual Investment Strategy 2018/19
- Investment Outturn for 2018/19
- Long Term Borrowing and Debt Rescheduling
- Short Term Borrowing
- Prudential Code for Capital Finance in Local Authorities

The Economy and Interest Rates 2018/19

4.2 After spiking at $85/barrel in October 2018, oil prices fell back sharply by the end of the year, declining to just over $50 in late December before steadily climbing towards $70 in April 2019

4.3 UK Consumer Price Inflation (CPI) for February 2019 was up 1.9% year-on-year, just above the consensus forecast but broadly in line with the Bank of England's Inflation Report. The most recent labour market data for the three months to January 2019 showed the unemployment rate fell to a new low of 3.9% whilst the employment rate of 76.1% was the highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.4% as wages continue to rise steadily and provide some upward pressure on general inflation. Once adjusted for inflation, real wages were up 1.4%

4.4 After rising to 0.6% in the third calendar quarter from 0.4% in the second, fourth quarter economic growth slowed to 0.2% as weaker expansion in production, construction and services dragged on overall activity. Annual GDP growth at 1.4% continues to remain below trend.

4.5 Following the Bank of England's Monetary Policy Committee (MPC) decision to increase Bank Rate to 0.75% in August, no further changes to monetary policy were made.

4.6 With the 29 March 2019 original EU 'exit day' now been and gone, having failed to pass a number of meaningful votes in Parliament, MPs voted by a majority of one (313 to 312) to force the Prime Minister to ask for an extension to the Brexit process beyond 12 April in order to avoid a no-deal scenario. The ongoing uncertainty continues to weigh on sterling and the UK markets

4.7 While the domestic focus has been on Brexit's potential impact on the UK economy, globally the first quarter of 2019 has been overshadowed by a gathering level of broader base economic uncertainty. The US continues to be set on a path of protectionist trade policies and tensions with China in particular, but with the potential for this to spill over into wider trade relationships, most notably with the EU. The EU itself appeared to show signs of a rapid slowdown in economic growth with the major engines of its economy, Germany and France, both suffering misfires from downturns in manufacturing alongside continued domestic / populist unrest in France. The IMF downgraded its forecasts for global economic growth in 2019 and beyond as a consequence.

2018/19 Treasury Management Strategy

4.8 The Treasury Management Strategy, incorporating the Annual Investment Strategy, was approved by the Council at its meeting on 14 February 2018 (Paragraph 12 of the Minute refers).

4.9 The Council's main objective when borrowing is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective

4.10 Given the significant cuts to local government funding, the Council's borrowing strategy continued to address the key issue of affordability without compromising the longer term stability of the debt portfolio. With short-term interest rates much lower than long-term rates, it was more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead. By adopting this approach, the Council is able to reduce net borrowing costs and reduce overall treasury risk.

4.11 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.

Annual Investment Strategy

4.12 The Council's primary principle when investing is the security of capital and liquidity of its investments. The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. It is considered to be prudent to only invest with highly credited UK financial institutions that have a long-term credit rating of BBB+ or higher.

4.13 The Council's creditworthiness policy has been formulated after consultation with Arlingclose, the Council's treasury advisers The Head of Financial Services maintains a counterparty list in compliance with the minimum criteria approved by Full Council on 14 February 2018 (para 12 refers) and any revision to the criteria is submitted to Council for approval as necessary.

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

Investment Outturn for 2018/19

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

4.16 The table below shows the overall investment undertaken by the Council during 2018/19.

	Total Sum Deposited (£m)	Average Rate (%)
Approved Financial Institutions	59.595	0.59
Council's Bankers	214.389	0.63
TOTAL	273.984	0.61

The above figures are cumulative and the actual amounts invested at any one time ranged from £4.9 million to £35.49 million.

4.17 The average rate of interest earned on investments during the year was 0.61%, compared to the average 7 day London Inter Bank Bid Rate (LIBID) of 0.62%.

4.18 As at 31 March 2019, the following balance was invested:

Counterparty	Investment	Amount (£m)	Interest Rate (%)
Bank of Scotland	Call Account	3.58	0.65
Aberdeen Standard	Money Market Fund	5.0	0.79
Federated	Money Market Fund	5.0	0.79
Blackrock	Money Market Fund	5.0	0.75
Insight	Money Market Fund	2.0	0.70
	Total	20.58	0.75

Long Term Borrowing and Debt Rescheduling

4.19 The Council's long term external debt position at 31 March 2019 compared with the position at the end of the last financial year was as follows:

	31 March 2018			31 March 2019		
	Actual (£000)	Rate (%)	Average Life (Years)	Actual (£000)	Rate (%)	Average Life (Years)
Fixed Rate Funding – PWLB Fixed Rate Funding – Market	127,128 34,075	5.26 4.61	20.01 55.65	146,253 33,400	4.82 4.68	19.40 54.82
Variable Rate Funding - PWLB Variable Rate Funding - Market	- -	- -	- -	- -	- -	- -

Total Debt	161,203	5.12		179,653	4.80	

4.20 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.

4.21 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.

4.22 To avoid having too large a percentage of short-term debt (i.e. repayable in less than 12 months) compared to the overall debt portfolio, advantage was taken of historically low interest rates to borrow the following long term loans from the Public Loans Board (PWLB).

Amount (£)	Rate (%)	Term (years)	Repayment Type
10,000,000	1.87	10	EIP*
10,000,000	1.92	15	EIP*
5,000,000	1.96	15	EIP*

*The loan will be repaid by equal annual instalments (EIP) over the period of the loan.

4.23 No debt rescheduling was undertaken during the year as the differential between PWLB new borrowing rates and PWLB premature repayment rates made rescheduling unviable.

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

Short Term Borrowing

4.25 During the year, forty new temporary loans totalling £54.5 million were borrowed from other UK local authorities. A table detailing the short term loans outstanding at 31 March 2019 can be found at **APPENDIX 1**

The Prudential Code for Capital Finance in Local Authorities

4.26 The Local Government (Scotland) Act 2003 requires the Council to undertake its treasury activities with regard to the Prudential Code for Capital Finance in Local Authorities.

4.27 The Code requires the Council to produce mandatory indicators aimed at assisting members in ensuring that proposed capital investment levels and treasury management decisions satisfy the key requirements of affordability, prudence and sustainability. The Prudential Indicators for 2018/19 were approved by the Full Council on 14 February 2018 (paragraph 12 of the minute refers). There were no breaches of these indicators during 2018/19. Performance against key indicators is shown in the **APPENDIX 2.**

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
All financial considerations are contained within the body of the report and the attached **APPENDIX 2.**

(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.

(a) 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. <u>CONCLUSION</u>

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 2018/19.

Author of Report: Paul Connor, Principal Accountant
Background Papers: Various working papers held within Financial Services
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