ITEM No …12…

REPORT TO: **POLICY & RESOURCES COMMITTEE – 7 JANUARY 2019**

REPORT ON: **TREASURY MANAGEMENT ACTIVITY 2018/2019 (MID-YEAR REVIEW)**

REPORT BY: **EXECUTIVE DIRECTOR OF CORPORATE SERVICES**

REPORT NO: **14-2019**

1 PURPOSE OF REPORT

To review the Treasury Management activities for the period 1 April to 30 September 2018.

2 RECOMMENDATION

The Committee is asked to note the information contained herein.

3 FINANCIAL IMPLICATIONS

The Treasury Management activity during the first half of the current financial year indicates that the Loans Fund interest rate of 4.00%, assumed when setting the 2018/2019 Revenue Budget, will be achieved. A saving of around £1,318,000 against budget provision for capital financing costs in HRA and General Services is being projected. Capital financing costs are continually monitored throughout the financial year.

4 BACKGROUND

The Council operates a balanced budget, which broadly means cash raised during the year will meet its revenue cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

At its meeting on 23rd April 2018, the Policy and Resources Committee approved the Council's Treasury Policy Statement (Report no. 126-2018, article XI of minute refers) setting out the policies which would govern all borrowing and lending transactions carried out by the Council.

The Treasury Policy Statement requires that the Policy and Resources Committee will receive and consider the Treasury Management Strategy at the beginning of each new financial year.

On 23rd April 2018, the Policy and Resources Committee approved the Council's Treasury Management Strategy for 2018/2019 (Report no. 127-2018, article XII of minute refers).

This monitoring report covers the Treasury Management activity over the first six months of 2018/2019 financial year.

5 **DEBT POSITION**

The Council's gross debt position at the beginning and mid-point of the financial year was as follows:-

Funding type		1 April 2018 Principal £m	1 April 2018 Average Rate %	30 September 2018 Principal £m	30 September 2018 Average Rate %
Long-term Fixed Rate	PWLB	408.5	4.5	404.0	4.5
	Market	25.0	4.3	25.0	4.3
Long-term Variable Rate	PWLB	-	-	-	-
	Market	15.0	4.6	15.0	4.6
Total Long-term Debt		448.5	4.5	444.0	4.5
Short-term Fixed Rate	Market	88.1	0.6	112.1	0.8
Total Debt		536.6	3.9	556.1	3.8

6 **ACTUAL BORROWING**

6.1 **Long-Term**

Public Work Loans Board

No long term borrowing has been undertaken during this activity period.

6.2 **Short-Term**

In order to indicate the level of short-term borrowing, shown below are the lowest and highest daily amounts outstanding each month, together with the short-term borrowing position at the end of every month and the range of interest rates at which borrowings were made:-

Month	Lowest Amount Outstanding £m	Highest Amount Outstanding £m	End of month Amount Outstanding £m	Interest Rate Range %	
2018				Min	Max
April	83.1	93.1	93.1	0.38	1.00
May	88.1	93.1	91.1	0.39	1.00
June	86.1	91.1	91.1	0.39	1.00
July	91.1	101.1	101.1	0.39	1.00
August	101.1	104.1	104.1	0.39	1.00
September	102.1	112.1	112.1	0.50	1.02

The Council's Treasury Strategy document provides that the amount of the overall borrowing which may be outstanding by way of variable rate exposure should be no greater than 30% of net borrowings included in Prudential Code Indicators (circa £165m).

7 **ACTUAL LENDING**

Balances on reserves and variations in cash flow requirements mean that there will be surplus funds which will be invested for short periods (maximum of 364 days). Short term investments will be restricted only to those institutions identified in the Council's Approved Counterparties list provided they have maintained a suitable credit rating.

The lending figures shown include funds held on behalf of Tay Road Bridge Joint Board, Tayside Valuation Joint Board and Tayside Contracts.

An analysis of the lending position to 30 September 2018 shows:

Month	Lowest Amount Lent £m	Highest Amount Lent £m	End of month Amount Lent £m	Interest Rate Range %	
2018				Min	Max
April	4.0	27.0	4.0	0.44	0.50
May	2.0	15.2	4.7	0.46	0.52
June	5.2	18.6	5.2	0.50	0.53
July	1.9	16.3	1.9	0.52	0.55
August	2.1	20.4	2.1	0.54	0.64
September	2.1	17.3	4.8	0.63	0.67

All of these loans were in compliance with the Treasury Policy Statement.

8 SPECIFIED INVESTMENTS

In accordance with the Treasury Management Strategy, in specific circumstances, specified funds identified by the Executive Director of Corporate Services are invested in longer term investment vehicles. These funds are Common Good; General Insurance; and Maintenance and Perpetuity of Lairs. These investments may have a higher risk threshold and can be subject to market fluctuation. Investment activity in the current financial year is summarised as follows:

Value of funds invested at 1 April 2018	£8,227,582
Withdrawals made within period	0
Value of funds invested at end of period	£8,227,582
Value of funds at 30 September 2018	£8,105,186
Capital Growth of Investments	(£122,396)
Income from Investments	£144,295
Total Return on Investments in period	£21,899

The specified investment portfolio has decreased in value but continues to provide the required budgetary income.

9 OUTLOOK FOR THE SECOND HALF OF 2018/2019

The Council's treasury advisor, Link Asset Services, interest rate forecasts are provided in the table below. The forecasts are predicated on an assumption that there is no break-up of the Eurozone or EU (apart from the departure of the UK) within the forecasting time period, and that there is no further unrest in international relations which would have major impact on international trade and world GDP growth.

Link Asset Services do not currently believe that the Monetary Policy Committee (MPC) of the Bank of England will increase the bank rate in February 2019, ahead of March Brexit deadline. However, in view of the hawkish stance of the MPC, on 6th November 2018 they moved forward their first forecast of increase in bank rate from August 2019 to May 2019, with following increases in February and November 2020, ending up at 2.0% in February 2022. See Appendix 2 for an economic review.

Link Asset Services Interest Rate View

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	0.90%	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.10%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

The key changes to Link's forecasts are highlighted below:

BANK RATE	now	previously
Q1 2019	0.75%	0.75%
Q1 2020	1.25%	1.00%
Q1 2021	1.50%	1.50%

10 **PRUDENTIAL CODE INDICATORS**

The Treasury Management activity at mid year was maintained within the prudential code limits. Updated indicators are shown in Appendix 1. Limits for future years have been amended to take account of current expectations.

11 **RISK**

The Treasury Risks have been reviewed and the following changes have been made to the Treasury Risk Register attached in Appendix 3:

Risk 1 – The profile of this risk has changed following re-evaluation of risk using the Council's approved risk assessment matrix. The risk remains however at the same level of risk classification.

Risk 8 – Lack of expertise of committee or amongst officers – This risk has been reduced due to additional training and briefings provided and growing experience of Committee members.

Please note that the following risks remain heightened due to the current uncertain economic climate:

Risk 2 – Decline / Rise in interest rates
Risk 6 – Risk that revenue budgets are unable to meet borrowing costs of capital schemes.

12 **POLICY IMPLICATIONS**

This report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management. There are no major issues other than the risks noted in the Treasury Risk Register contained within the report.

13 **CONSULTATIONS**

The Council's Management Team have been consulted in the preparation of this report.

14 **BACKGROUND PAPERS**

None.

GREGORY COLGAN
EXECUTIVE DIRECTOR OF CORPORATE SERVICES **18 DECEMBER 2018**

APPENDIX 1

1. CAPITAL EXPENDITURE INDICATORS

1.1 Level of Capital Expenditure

This indicator measures affordability and gives a basic control of the Council's capital expenditure. To provide an accurate indicator of capital expenditure all receipts are excluded from the calculation, so figures are based on gross expenditure.

1.2 Ratio of Financing Costs to Net Revenue Stream

This also measures affordability. The measure includes both current and future commitments based on the Capital Plan and shows the revenue budget used to fund the capital financing costs associated with the capital expenditure programme.

Variations to the ratio imply that the proportion of loan charges has either increased or decreased in relation to the total funded from Government Grants and local taxpayers.

1.3 Estimate of Incremental Impact of Capital Investment Decisions on the Council Tax

This is also a measure of affordability. It shows the relative impact of the capital programme on the Council Tax. The indicator takes into consideration the effects of self-financing capital projects funded from existing Revenue Budgets, the effects of government funded projects and reflects the revenue impact of capital schemes on capital financing costs. The variation in the indicators shows the incremental impact of the capital investment decisions within this 5 Year Plan on the Council Tax, with all other items held constant. In reality the Council will manage its Capital Financing Costs budget in the same way as other revenue budget headings to avoid a detrimental impact on Council Tax.

2. TREASURY MANAGEMENT INDICATORS

The Annual Treasury Management Activity for 2017/2018 (including Prudential Indicators covering period 2017/2018 to 2022/2023 was reported to Policy & Resources Committee on 25 June 2018 (Report No 167-2018 Article VI of the minute of the meeting refers). These have now been updated to reflect projected expenditure included in the 2019-2024 Capital Plan.

PRUDENTIAL CODE INDICATORS - TREASURY MANAGEMENT INDICATORS

Adoption of Revised CIPFA Treasury Management Code of Practice | Yes

Upper limit for variable and fixed rate exposure

	Net principal re variable rate borrowing / investments	Net principal re fixed rate borrowing / investments
2017/18	30%	100%
2018/19	30%	100%
2019/20	30%	100%
2020/21	30%	100%
2021/22	30%	100%
2022/23	30%	100%
2023/24	30%	100%

Actual External Debt

	£'000
Actual borrowing as at 31/03/2018	536,587
Actual other long term liabilities as at 31/03/2018	70,113
Actual external debt as at 31/03/2018	**606,700**

Maturity structure of fixed rate borrowing 2017/18

Period	Lower %	Upper %
Under 12 months	0	10
12 months & within 24 months	0	15
24 months & within 5 years	0	25
5 years & within 10 years	0	25
10 years +	50	95
Upper limit for total principal sums invested for over 364 days	n/a	No sums will be invested longer than 364 days

External debt, excluding investments, with limit for borrowing and other long term liabilities separately identified

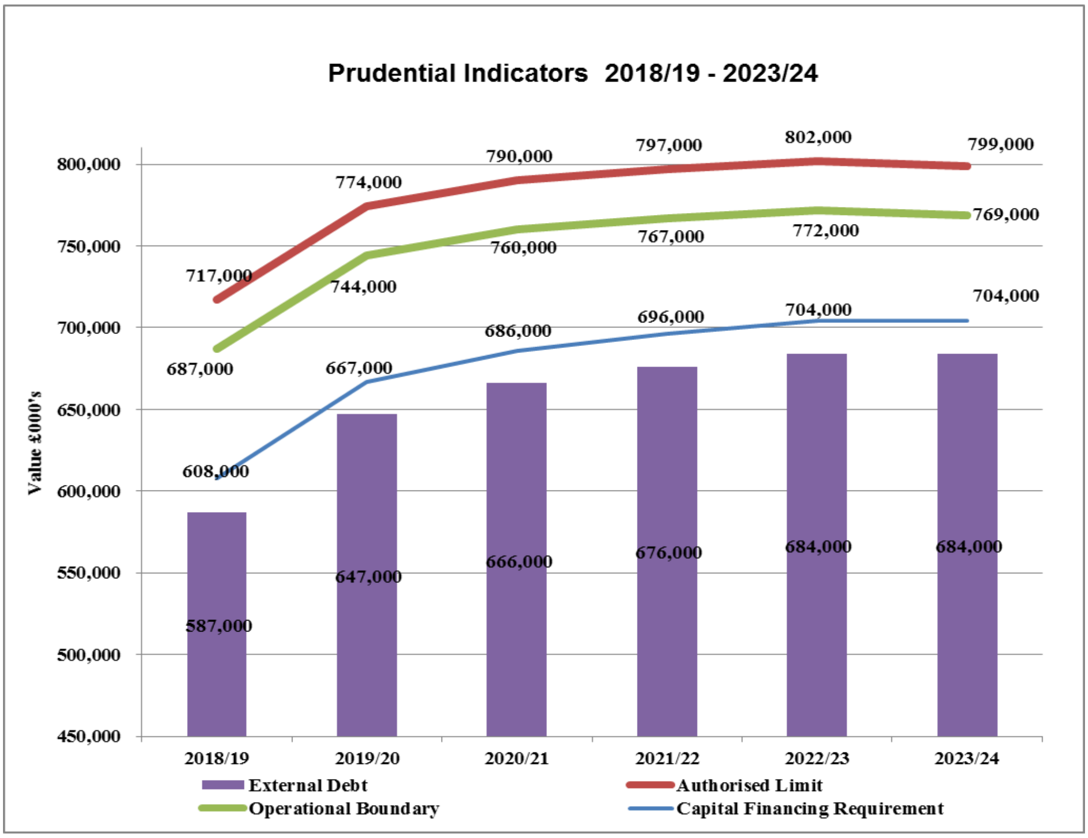
	Authorised Limit			**Operational Boundary**		
	Borrowing £000	Other £000	Total £000	Borrowing £000	Other £000	Total £000
2017/18	561,587	70,113	631,700	536,587	70,113	606,700
2018/19	621,000	96,000	717,000	591,000	96,000	687,000
2019/20	681,000	93,000	774,000	651,000	93,000	744,000
2020/21	700,000	90,000	790,000	670,000	90,000	760,000
2021/22	710,000	87,000	797,000	680,000	87,000	767,000
2022/23	718,000	84,000	802,000	688,000	84,000	772,000
2023/24	718,000	81,000	799,000	688,000	81,000	769,000

PRUDENTIAL CODE INDICATORS - PRUDENTIAL INDICATORS

	Capital Expenditure			**Ratio of financing costs to net revenue stream**	
	Non-HRA £000	HRA £000	Total £000	Non-HRA %	HRA %
2017/18	105,036	22,387	127,423	8.2	37.9
2018/19	113,583	23,533	137,116	7.7	39.3
2019/20	88,886	35,520	124,406	7.5	39.7
2020/21	45,204	23,974	69,178	8.0	37.8
2021/22	35,816	18,583	54,399	8.0	38.3
2022/23	33,485	21,085	54,570	8.0	39.2
2023/24	23,550	21,085	44,635	8.0	38.7

	Net Borrowing Requirement (NBR)			Capital Financing Requirement (CFR)			
	1 April £000	31 March £000	Movement £000	Non-HRA £000	HRA £000	Total £000	Movement £000
2017/18	495,786	533,169	37,383	376,594	178,098	554,692	48,643
2018/19	533,169	587,000	53,831	428,000	180,000	608,000	53,308
2019/20	587,000	647,000	60,000	475,000	192,000	667,000	59,000
2020/21	647,000	666,000	19,000	487,000	199,000	686,000	19,000
2021/22	666,000	676,000	10,000	494,000	202,000	696,000	10,000
2022/23	676,000	684,000	8,000	498,000	206,000	704,000	8,000
2023/24	684,000	684,000	-	493,000	211,000	704,000	-

	NBR v CFR Difference
	Total £000
2017/18	21,523
2018/19	21,000
2019/20	20,000
2020/21	20,000
2021/22	20,000
2022/23	20,000
2023/24	20,000



APPENDIX 2

ECONOMIC BACKGROUND

GLOBAL OUTLOOK. World growth has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China, overall world growth is likely to weaken.

Inflation has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to a marked acceleration of wage inflation which is likely to prompt central banks into a series of increases in central rates. The EU is probably about a year behind in a similar progression.

KEY RISKS - Central Bank Monetary Policy Measures

The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation is coming towards its close and a new period has already started in the US, and more recently in the UK, on reversing those measures i.e. by raising central rates and, (for the US), reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of an on-going reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets.

UK - The first half of 2018/19 has seen UK economic growth post only a modest performance. However, growth has been recovering pace and the latest 3 month rolling average came in at a healthy 0.7%. The positive run of economic statistics was sufficiently robust for the Monetary Policy Committee, (MPC), to unanimously (9-0) vote to increase Bank Rate on 2nd August from 0.5% to 0.75%. Although growth looks as if it will only be modest overall at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report forecast that growth will pick up to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

Some MPC members have expressed concerns about a build-up of inflationary pressures, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation came in at 2.4% in September and is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate.

As for the labour market, unemployment has continued at a 43 year low of 4% on the Independent Labour Organisation measure. Given that the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. However, the MPC will need to tread cautiously before increasing Bank Rate again, especially given all the uncertainties around Brexit.

USA - The Federal has had four increases in 2018, and indicated they expected to increase rates four more times by the end of 2019.

Eurozone - Growth was unchanged at 0.4% in quarter 2, but has undershot early forecasts for a stronger economic performance in 2018. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank has indicated it is likely to end all further purchases in December 2018. Inflationary pressures are starting to build gently so it is expected that the ECB will start to increase rates towards the end of 2019.

China - Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. There are concerns that official economic statistics are inflating the published rate of growth.

Japan - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

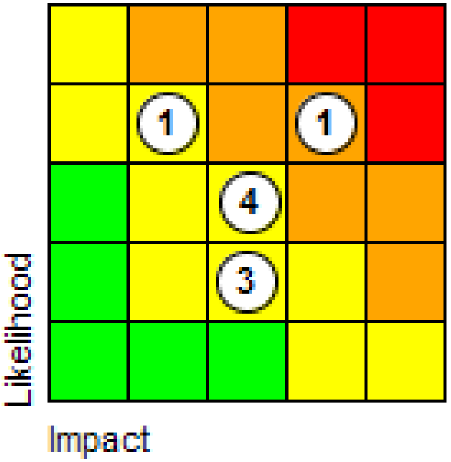
APPENDIX 3

Six Monthly Risk Report

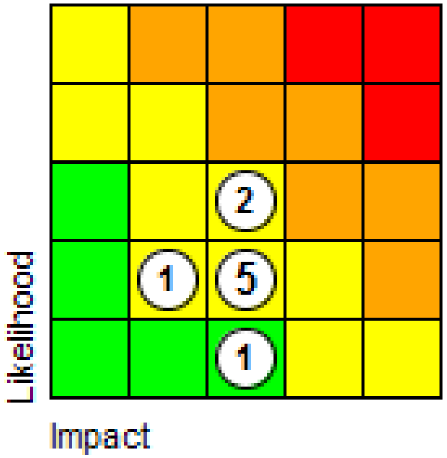
Treasury Risk Register Report
Report Author: Executive Director of Corporate Services
Generated: December 2018

Total Risk Summary

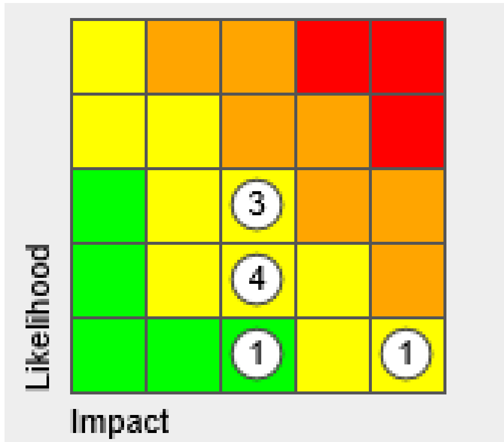
Inherent Risk



Risk at last report May 2018

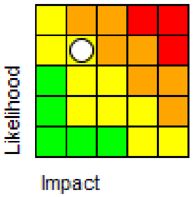
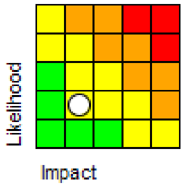
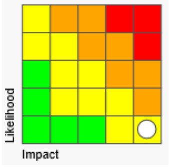
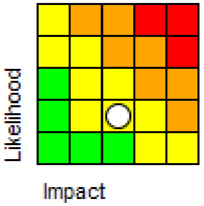
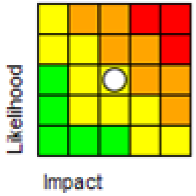
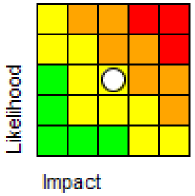


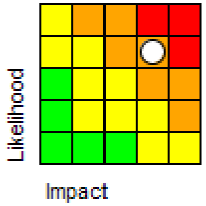
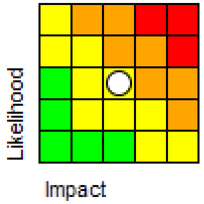
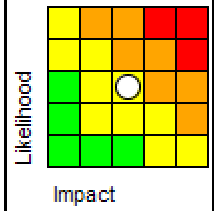
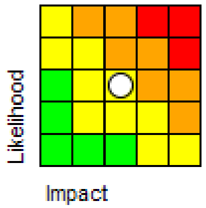
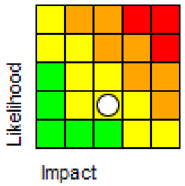
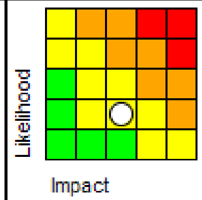
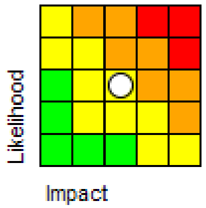
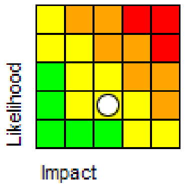
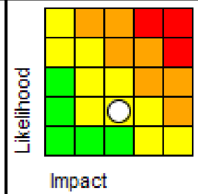
Residual Risk Dec 2018

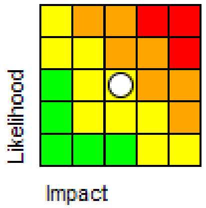
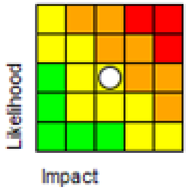
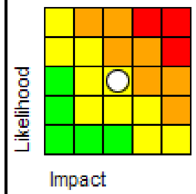
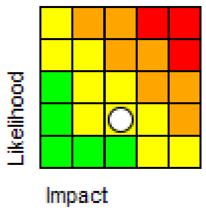
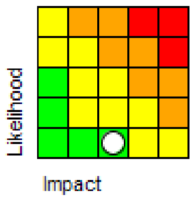
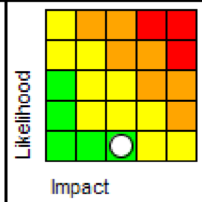


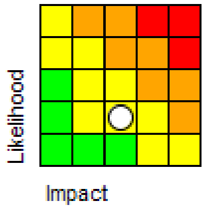
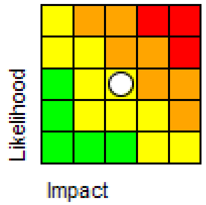
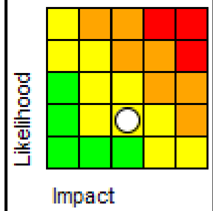
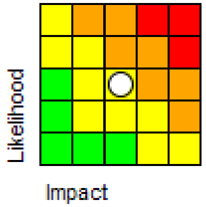
Six Monthly Risk Report

Treasury Risk Register Report
Report Author: Executive Director of Corporate Services
Generated on: December 2018

Risk Title	Risk Factors	Potential Effect	Potential Outcome	Inherent Risk	Control Measures/Mitigation	Risk May 2018	Residual Risk
1. Loss of capital due to counterparty collapse	The Council loses its principal investment or investment becomes impaired	Counterparty collapses or faces a financial crisis rendering it unable to repay investments	. The Council may suffer financial loss . The repayment of funds from the counterparty could be significantly delayed or impaired Either of these outcomes could have an adverse impact on operational funding levels		Per the Treasury Management Strategy: . Maximum investment value on approved counterparties in order to spread and reduce risk. . Controls and procedures are in place to ensure investment and durations limits with approved counterparties are not exceeded. . Counterparties are also monitored and reviewed on a weekly basis at least or more regularly if considered necessary to do so. Limiting the threshold rating for approval of counterparties.		
2. Decline / rise in interest rates	. The Council may not achieve its target level of interest for budgetary purposes. . Impact on revenue budget resulting in mandatory efficiencies affecting	Interest rates continue to remain at an all-time low with very little movement.	. No change to base rate and associated market investment rates. . Lower risk counterparties not offering competitive rates.		. Arranging longer term investments where investment objectives and criteria allows in order to capitalise on higher rate of returns without risk of opportunity cost. . Offsetting the loss of interest income by undertaking refinancing loans at lower rates than previously undertaken as opportunities arise. The Council continually monitors base rate and rates being achieved against budget to ensure it has		

Risk Title	Risk Factors	Potential Effect	Potential Outcome	Inherent Risk	Control Measures/Mitigation	Risk May 2018	Residual Risk
	service delivery				secured the best value possible in the challenging economic climate.		
3. Fraudulent activity (now incorporating cybercrime)	. Financial loss to the Council as a direct consequence of fraudulent activity . Loss of money for the Council Disciplinary action for the staff involved . Reputational damage	Potential fraud by staff	Fraudulent activity		. Segregation of staff duties. . Review and monitor of internal controls to ensure the correct protocol across all relevant areas is being followed. . Ensure all insurance policies and relevant guarantees (Fidelity £2m per individual circumstance) are fully up to date.		
4. Money laundering	. Fine and/or imprisonment . Reputational damage	Money laundering by external parties	External parties pay a transaction by cash and subsequently request a refund		. Ensure the money laundering policy is reviewed and up to date. . Reconcile refunds back to source of income. . Raise awareness of this issue amongst staff . Review requirements of financial regulations.		
5. Network Failure / banking system being inaccessible	Daily Treasury functions will not be carried out	The Council is unable to carry out its daily treasury functions due to a network failure	RBS Bankline is unavailable or the Council's network has failed		Invoke the business continuity plan to minimise the effects of a network issue.		

Risk Title	Risk Factors	Potential Effect	Potential Outcome	Inherent Risk	Control Measures/Mitigation	Risk May 2018	Residual Risk
6. Revenue Budgets	The Council may not be able to execute some desired projects	Revenue budgets are unable to meet borrowing costs of capital schemes	Revenue budgets come under pressure from restricted government funding or non-delivery of programmed savings		. Revenue budgets monitored on monthly basis and future year forecasts undertaken. . Reserve some capital receipts to cover borrowing costs in the short term. . Ensure monthly financial reports and Forecasts are produced and analysed . All borrowing decisions are made based on prudential indicators and are planned based on long term projections. . Capital Plans and borrowing is reviewed annually before the revenue budget is set to ensure that the costs are affordable.		
7. Lack of suitable counterparties	Use of counterparties not paying best value rates.	The Council does not have enough "space" with approved counterparties to place investments/deposit surplus cash balances.	Rising cash balances and a restricted counterparty list		The Council continually monitors its approved counterparty listing in conjunction with cash balances. Any potential new investment opportunities are discussed at Treasury Management performance meetings. The Council uses call accounts and money market funds to deposit surplus cash balances in the event of no space with other counterparties and also to ensure there is always cash instantly available in order to meet payment obligations when they fall due. However, there are also limits on the amounts deposited to such funds. The Council has a facility to deposit cash with the Debt Management Office should all other investment options be exhausted.		

Risk Title	Risk Factors	Potential Effect	Potential Outcome	Inherent Risk	Control Measures/Mitigation	Risk May 2018	Residual Risk
8. Lack of expertise of Committee or amongst officers	Financial consequence	Lack of training and continuous professional development.	Detrimental decisions made in relation to financial investment management.		. Provision of training . External investment advice . Consultation with peer groups.		
9. Over reliance on key officers	Detrimental decisions made in relation to financial investment management.	Specialist nature of work means there are relatively few experts in this field	If an officer leaves or falls ill knowledge gap may be difficult to fill.		. Key officers transfer specialist knowledge to colleagues. . Procedures & guidance available. . In the short-term advice can be sought from external investment adviser and/or peer support.