Aberdeenshire COUNCIL Business Services

BUSINESS SERVICES COMMITTEE – 28 FEBRUARY 2019

REVIEW OF THE PERFORMANCE OF THE TREASURY MANAGEMENT FUNCTION AND INVESTMENTS FOR THE PERIOD TO 30 SEPTEMBER 2018

1. Recommendation

The Committee is recommended to:

1.1 Note the details of the review of performance of the Treasury Management function and investments for the period to 30 September, 2018; and

1.2 Agree that a further report be provided after the end of the financial year on the outturn review of the performance of the Treasury Management function for the period 1 April, 2018, to 31 March, 2019.

2. Background / Discussion

2.1 This report details performance in relation to the Treasury Management and investment activity for the period to 30 September, 2018. It also documents compliance and monitoring in relation to the Treasury Management Strategy Statement and Prudential Indicators for the period 1 April, 2018, to 30 September, 2018.

2.2 The Code of Practice for Treasury Management by Local Authorities, issued by the Chartered Institute of Public Finance and Accountancy (CIPFA), which forms part of the Council's Financial Regulations, states that the performance of the Treasury Management function should be reviewed at least twice per annum. Reports are now prepared covering operational performance on this basis.

2.3 The Treasury Management Strategy Statement and Prudential Indicators which underpin Treasury Management activity are approved annually by the Business Services Committee. The Strategy Statement incorporates the Investment Policy and Long-Term Borrowing Strategy.

2.4 Money Market Review & Investment Activities

2.4.1 **Summary:** The performance of the Treasury management function has been challenging given the constraints of the current Medium-Term Financial Strategy (MTFS) and a sustained period of low investment rates. To mitigate this, in the year to date, we have taken advantage of higher cash balances and, through active cash flow management, we have invested funds over a longer term, generating higher than budget returns.
Looking at the Performance Indicators in Appendix B, the average cost of raising and servicing borrowing, as a % of amounts owed to the Loans Fund from Council Services, is forecast to reduce, as maturing borrowing has been actively replaced with lower level interest rates.

2.4.2 **Bank rate:** The Bank rate was 0.50% at the start of financial year 2018/19 and has risen to 0.75% during this reporting period, due to a flow of positive economic data in the first half of 2018 and concerns about a build-up of inflationary pressures.

2.4.3 **Investment Income**: The Revenue Budget assumes investment income of £60,000 in 2018/19 and the return for quarters 1 and 2 is detailed in **Table A** below. Investment income is above budget due to average cash balances being higher than anticipated and by locking investments out over longer periods, in order to achieve a more favourable return.

Table A: Return of Treasury Management Investment Income

	Budget	Q1	Q2	F/cast
	£000s	£000s	£000s	£000s
Interest Earned	60	74	97	275
Average Cash Balances	12,000	51,472	55,669	41,956
Annualised % Return	**0.50%**	**0.57%**	**0.70%**	**0.66%**

2.5 **Repayments/Restructuring:** There has been no repayment or restructuring of debt undertaken during the reporting period. This option is reviewed on a weekly basis by the Treasury Management function and, although borrowing rates are still at historically low levels, they restrict restructuring opportunities.

New Borrowing: No new longer-term borrowing has been taken in this reporting period. In line with the Council's current MTFS, any capital or cash flow requirements are being met from existing deposits or short-term temporary borrowing with no cost of carry.
The strategy of no new long-term borrowing is regularly reviewed to ensure that longer-term borrowing options are reviewed in line with the MTFS.

2.6 Details of both Treasury Management and other investment activities undertaken during this reporting period are highlighted in **Appendix A**.

2.7 During the reporting period there were no instances of the Treasury Management Strategy Statement being in breach of counterparty limits per the permitted Investments Schedule, or breaching the prudential indicators relating to fixed and variable borrowing.

2.8 **UK Economic Outlook**

Monetary: The first half of 2018/19 showed that UK economic growth continued to improve at a moderate pace but sufficiently robust for the UK Monetary Policy Committee (MPC) to increase the Bank Rate in August from 0.50% to 0.75%. There are still concerns about a build-up of inflationary pressures, particularly with the pound falling in value against both the US Dollar and The Euro. Inflation rose unexpectedly in August but is expected to fall back to the 2% inflation target over the next 2 years, given a scenario of minimal increases in the Bank Rate. The MPC indicated the Bank Rate may need to be in the region of 1.5% by March, 2021, for inflation to stay on track. Financial Markets are currently pricing in the next increase for the second half of 2019.

Fiscal: Unemployment has continued at a 43-year low and has seen wage inflation pressures starting to rise. Increased household spending power could support UK growth but the MPC will monitor wage inflation as, if this is in excess of 3%, it would create increasing inflationary pressures within the UK economy.

Brexit: The main risk, however, is whether the UK achieves an orderly withdrawal from the European Union in March, 2019. There is a risk that the current minority government may be unable to muster a majority in the Commons over Brexit. Should this happen and the UK faces another general election in the next 12 months, it could lead to a loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up. The view at present is that the Bank Rate may rise in the second half of 2019, but further interest rate rises would be limited and gradual. Rates would not return to the pre-financial crisis levels.

2.9 **US Economic Outlook:** The US economy continued to show growth in 2018, fuelled by a boost in consumption due to massive easing of fiscal policy, but has led to increased inflationary pressure. The Federal Reserve increased rates for a fourth time in 2018 by 0.25% to between 2.00% and 2.25% and have indicated 4 more rises will occur by the end of 2019. The dilemma, however, is that when this temporary boost to consumption wanes, particularly with the imposition of tariffs on countries the US exports to, they could see a rise in prices, which may limit the Federal Reserve's ability to ease monetary policy further.

European Economic Outlook: Uncertainty of the effect of the UK's exit from the EU will continue to cause volatility on financial markets going forward. Growth in the EU was unchanged in quarter 2 and has undershot early forecasts of a strong economic performance in 2018. Germany has had mixed data and could be negatively impacted by the US tariffs on a significant part of manufacturing exports e.g. vehicles.

2.10 **UK Banks**: During the reporting period, the ratings of UK institutions have seen very little volatility. UK banks are more highly capitalised than before the banking crisis and impaired lending is at the lowest rates since 2010. One of the major ratings agencies has tried to estimate the impact of a no Brexit deal and UK Banks should weather any storm. The more important thing that could affect ratings is the UK sovereign rating, which is currently on negative outlook. If the UK fails to reduce its debt as forecast, there may be a ratings downgrade, which would have a knock-on effect. Events will continue to be monitored on a continuous basis.

Government-backed UK Banks: We will also continue to monitor Government-Backed Banks, which our Treasury Advisors recommend investing in up to a maximum of 12 months. Lloyds Banking Group has been in private ownership since 2017. The Government continues its process to return Royal Bank of Scotland to private ownership through managed tranches: in June, 2018, it reduced its share from 70.1% to 62.4%.

2.11 **Clydesdale Bank:** The Council retendered for banking services in 2018, with Clydesdale Bank successful in retaining the contract. Clydesdale Bank's Long-Term ratings were downgraded by all the credit rating agencies following its demerger from its parent company, National Australia Bank Ltd (NAB), in 2016.

As a result, Clydesdale Bank has sufficient capital and liquidity buffers necessary to continue as a standalone entity. Indeed, they recently acquired Virgin Money to grow the business and we will monitor how the merged business progresses, in conjunction with our treasury advisors, through review of performance and rating outlooks.

As reported as part of our Investment Policy, Clydesdale Bank is now no longer on our treasury advisors' list of acceptable financial institutions for investment. A recent review of the standalone entity by Moody's rating agency resulted in an improvement in their long and short-term outlooks, moving from a stable to positive outlook.

2.12 Following downgrades in the past, officers changed their operational procedures in relation to Clydesdale Bank. As a means of managing the risk of a further deterioration in the bank's standing, the maximum investment period was reduced to Instant Access Accounts and this practice continues, as the outlook is still not at a level where investment levels will be altered. As such, Clydesdale Bank is currently not included on our treasury advisors' suggested counterparty investment list.

3 Scheme of Governance

3.1 The Committee is able to consider this item in terms of Section C.2.7 of the List of Committee Powers in Part 2A of the Scheme of Governance.

4 Implications and Risks

4.1 An equality impact assessment is not required because the recommended actions do not have a differential impact on people with protected characteristics.

4.2 There are no staffing implications as a direct result of this report and there are no direct financial implications arising from this report. The combined General Fund and HRA financing cost as at 30 September, 2018, is forecast to be in line with budget as follows - £37,240,000 (General Fund: £30,340,000 and HRA: £6,900,000) in 2018/19. Proactive investment and debt management has been essential in the management of this budget.

4.3 The following Risk has been identified as relevant to this matter on a Strategic Level: Balancing the Books (*Directorate Risk Registers*).

Ritchie Johnson
Director of Business Services

Report prepared by: Bruce Lawrence – Treasury Management Officer
14 January, 2019

Appendix A

1. New Borrowing

No new borrowing has been taken during the reporting period. This is in line with our Treasury Strategy and Medium-Term Financial Strategy.

2. Loan Repayment

No loans were repaid during the six months to 30 September, 2018.

3. Counterparties and Balances

Counterparty	Investment Status	Balance as at 30/09/18 £'s
Fixed Term Deposits		
Royal Bank of Scotland	Up to 365 days	10,000,000
Bank of Scotland	Up to 365 days	10,000,000
Total Fixed Term Deposits		**20,000,000**
Call Accounts		
Clydesdale Bank	Up to 365 days	14,850,000
Total Call Accounts		**14,850,000**
Total Investments		**34,850,000**

4. Other Investment Activity

Name	Principal Balance as at 31 March 2018	Investment Return - YTD		Principal Balance as at 30 September 2018
	£'s	**£'s**		**£'s**
Call Accounts	8,800,000	40,028		14,850,000
Money Market Funds	0	62,363		0
Fixed Term Deposits	10,000,000	68,342		20,000,000
	18,800,000	**170,733**		**34,850,000**
Trust Funds: Heritable Property	0	0		0
Trust Funds: Government Stocks	215,666	2,517		215,666
Trust Funds Shareholdings: Investment Trusts	90,360	1,218		90,360
Trust Funds Shareholdings: Unit Trusts	3,221,724	53,301		3,159,400
Trust Funds Shareholdings: Others	73,502	0		73,502
Investment in Loans Fund	2,817,885	8,729		2,887,293
	6,419,137	**65,765**		**6,426,221**
Common Good Funds: Heritable Property	1,370,133	0		1,370,133
Common Good Funds: Government Stocks	0	0		0
Common Good Funds Shareholdings: Unit Trusts	13,967	338		13,967
Investment in Loans Fund	1,456,326	4,460		1,447,768
	2,840,426	**4,798**		**2,831,868**
Adhoc loans incl. existing long-term debtors	10,406,078	143,172		10,148,984
Support for Aberdeenshire Business Scheme	168,752	1,126		164,064
	10,574,830	**144,298**		**10,313,048**
Investment Land and Buildings	1,712,350	0		1,712,350
Total	**48,346,743**	**385,594**		**56,133,487**

Appendix B

A. Compliance and Performance

1. Treasury Management Performance

(i) "Average cost of servicing Loans Fund advances in year"

Purpose: - The Loans Fund interest and expenses rates indicate the cost of raising and servicing the Council's borrowings as a percentage of amounts owing to the Loans Fund by the Council's services.

	2017/18 Actual	2018/19 Budget	2018/19 Forecast
Loans Fund Interest Rate	3.49%	3.41%	3.31%
Loans Fund Expenses Rate	0.02%	0.04%	0.04%
Total Rate	**3.51%**	**3.45%**	**3.35%**

The Loans Fund interest rate reflects rates applicable to the whole debt portfolio of the Council. Much of the Council's debt was borrowed in times when interest rates were much higher than at present.

(ii) "Average interest rate of longer-term borrowing (i.e. for one year or more) raised in-year": -

Purpose: - Indicates whether the Council is achieving value for money in its borrowings.

	2017/18 Actual	2018/19 Budget	2018/19 YTD
Average interest rate of longer-term borrowing	0.00%	2.50%	0.00%

No long-term borrowing has been taken to date in line with the MTFS referenced in section 2.5. Capital expenditure and cashflow have been covered from internal balances and temporary borrowing. Some long-term borrowing is forecast to occur later in the financial year.

(iii) "Average maturity of long-term borrowing raised in year"

Purpose: - Indicates whether the Council's borrowing strategy is appropriate to the prevailing interest rate environment. In times of low interest rates, it is desirable to borrow for long periods at fixed interest rates to guard against the risk that rates might increase. Conversely, in times of high interest rates, it can be desirable to borrow over shorter periods if rates are expected to fall.

	2017/18 Actual	2018/19 YTD
New borrowing	0.00 years	0.00 years
Debt rescheduling	n/a	n/a
Average	0.00 years	0.00 years

2. Compliance with Treasury Strategy

***(i) "Selection of counterparties for lending of surplus money in the Council Loans Fund"*: -**

Lending has been to the counterparties listed below. This complies with the conditions for lending included in the Investment Policy.

Table A: Interest Receivable Realised from Counterparties

Counterparty	**2018/19 Actual**
	£s
Bank of Scotland	30,739
Clydesdale Bank PLC	40,028
Federated Investors Sterling MMF	21,793
LGIM Sterling Liquidity MMF	17,179
Royal Bank of Scotland	37,603
SSGA Sterling Liquidity MMF	2,480
Standard Life Sterling Liquidity MMF	20,911
Total Interest Receivable	**170,733**

The conditions contained in the Investment Policy relating to the counterparties in Table A are that all counterparties are UK or EU domiciled and are checked weekly to our Treasury Advisors' suggested counterparty list.

(ii) *"Investment of the fund balances of trusts and common good funds"*

Investments held by trusts and common good funds administered by the council complied with the Investment Policy in the period 1 April, 2018, to 30 September, 2018.

(iii) *"Restriction of amount lent to any one borrower at any one time to £20M".*

There was no instance of the amount being breached during the reporting period. The review of lending is checked and maintained on a daily basis on the balance of advances to counterparties database maintained by the treasury function.

(iv) *"Restriction of temporary borrowing to 40% of the total capital debt outstanding at the time of borrowing"*

	Actual 2017/18	**YTD 2018/19**
Maximum Temporary Borrowing to Debt Outstanding	4.86%	11.75%

(v) ***"The minimum average life to maturity of all long-term borrowing will be at least 5 years"***

	Actual 2017/18	**YTD 2018/19**
Minimum Average Life to Maturity	24.46 years	24.17 years

(vi) ***"No more than the greater of 25% of all temporary borrowing or £30M will be taken from any one lender at any one"***

	Actual 2017/18	**YTD 2018/19**
	£'s	**£'s**
Maximum Outstanding with 1 lender	10,000,000	20,000,000*

*See **Greater London Authority** in Lenders table below.

The table details the lending taken at any point in time in the monitoring period from April to September, 2018. The graph details the actual temporary borrowing totals at the end of each month for comparison purposes.

Lender	**£'s**
City of Westminster	5,000,000
East Riding of Yorkshire Pension Fund	10,000,000
***Greater London Authority**	**20,000,000**
Hampshire County Council	2,500,000
London Borough of Brent	10,000,000
London Borough of Ealing	10,000,000
North Yorkshire County Council	5,000,000
Nottinghamshire Office of the Police & Crime Commissioner	5,000,000
Police & Crime Commissioner of Hampshire	2,500,000
Police & Crime Commissioner of Hertfordshire	5,000,000
Tees Valley Combined Authority	5,000,000
Vale of Glamorgan	3,000,000
West of England Combined Authority	10,000,000
West Yorkshire Combined Authority	15,000,000
Wokingham Borough Council	10,000,000
TOTAL	**118,000,000**

The following graph highlights the temporary borrowing position at the end of each month in the monitoring period April to September 2018.