AUDIT AND SCRUTINY COMMITTEE
MONDAY, 23 SEPTEMBER 2019

Please find attached report and appendix in respect of Item 9 on the agenda for the above meeting

9.	**Annual Treasury Management Report 2018/19** (Pages 1 - 18) Consider annual report by Chief Financial Officer on the Council's Treasury Management activities undertaken during financial year 2018/19 for review and scrutiny prior to Council approval. (Copy attached).	15 mins

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ANNUAL TREASURY MANAGEMENT REPORT 2018/19

Report by Chief Financial Officer

AUDIT & SCRUTINY COMMITTEE

23 September 2019

1 PURPOSE AND SUMMARY

1.1 **This report presents the annual treasury management activities undertaken during the 2018/19 financial year.**

1.2 The CIPFA Code of Practice on Treasury Management in the Public Services (the Code) requires an annual report on treasury management to be submitted to Council following the end of each financial year. This report highlights the Council's treasury activity undertaken in the year ended 31 March 2019 and the performance of the Treasury function.

1.3 Appendix 1 is the annual report of treasury management activities for 2018/19 and contains an analysis of performance against targets set in relation to Prudential and Treasury Management Indicators. The performance comparisons reported are based on the revised indicators agreed as part of the mid-year report approved on 29 November 2018.

1.4 The Appendix shows the Council's borrowing requirement to fund the capital investment undertaken during 2018/19, how much the council actually borrowed against the sums budgeted and the level of external debt within approved limits.

1.5 During the year the Council has again, where possible, deferred borrowing using surplus cash rather than undertaking new borrowing. However, the Council did undertake long term borrowing of £10m during the year, for the purposes of debt rescheduling.

1.6 Treasury management activity for the year has been undertaken in compliance with approved policy and the Code. The Council remains under-borrowed against its Capital Financing Requirement (CFR) at 31 March 2019.

2 STATUS OF REPORT

2.1 Due to competing deadlines, this report is being issued for consultation and publication on the Council agenda prior to its presentation to the Audit & Scrutiny Committee on 23 September 2019. Comments received from this Committee will be highlighted to Council at this meeting.

3 RECOMMENDATIONS

3.1 **It is recommended that the Members:**

(a) note that treasury management activity in the year to 31 March 2019 was carried out in compliance with the approved Treasury Management Strategy and Policy as detailed in this report and in Appendix 1;

(b) agree to increase the investment limit for AAA Money Market Funds from £20m to £25m.

4 BACKGROUND

4.1 The Council approved the Treasury Management Strategy (the Strategy) for 2018/19 at the Council meeting on 20 February 2018. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management in the Public Services (the Code) and CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

4.2 The Council received a mid-year report on 29 November 2018 and approved the revised Prudential and Treasury Management Indicators for 2018/19 following the updating of assumptions, in particular capital expenditure estimates.

4.3 As set out in the Strategy, the Audit and Scrutiny Committee has a role to scrutinise the Annual and Mid-Year Reports before submission to Council for final approval.

5 ANNUAL TREASURY MANAGEMENT REPORT TO 31 MARCH 2019

5.1 The Annual Treasury Management Report for 2018/19 is shown in Appendix 1.

5.2 Appendix 1 shows the Council's borrowing requirement to fund capital investment undertaken during 2018/19, how much the Council actually borrowed against the sums budgeted and the level of external debt carried on the Council's balance sheet within approved limits.

5.3 In addition, Appendix 1 contains an analysis of the performance against the targets set in relation to Prudential and Treasury Management Indicators. All of the 2018/19 target indicators reported are based on the revised indicators agreed as part of the mid-year report on 29 November 2018.

5.4 The key Prudential Indicators (PI) and Treasury Management Indicators (TI), detailing the impact of capital expenditure activities during the year to 31 March 2019, with comparators, are as follows:

	2018/19 Actual £m	**2018/19 Estimate* £m**	**Variance £m**
Actual Capital Expenditure *(PI-1)*	**47.8**	**54.9**	**(7.1)**
Total Capital Financing Requirement (CFR) *(PI-2)***	**315.2**	**316.4**	**(1.2)**
(Under)/Over Gross Borrowing against the CFR *(PI-6) ****	**(109.2)**	**(51.8)**	**(57.4)**

**Revised estimate, approved by Council 29 November 2018 as part of the mid-year report*

*** The CFR for this calculation is based on expenditure to 31 March 2019 only*

**** The CFR for this calculation includes the current year and projected movement for the next two subsequent years.*

(a) **PI-2 Total Capital Financing Requirement**

The year-end total CFR varied only marginally from that projected in the mid-year report.

(b) **PI-6 (Under)/Over Gross Borrowing against the CFR**

The reason for the increase in the level of under-borrowing, compared to that projected is due to the actual level of capital expenditure for 2018/19 being less than the projected value in the mid-year report, and an increase to the anticipated levels of capital expenditure in the next two subsequent years.

(c) **Investments**

Investments held on 31 March 2019 amounted to £2.7m. This is a reduction from the £7.6m at 31 March 2018 as temporary borrowing undertaken at the 2018 year-end to ensure cash was available to pay liabilities due but not physically paid until April, was not required in March 2019.

5.5 Treasury management activity for the year has been undertaken in compliance with the approved policy and the Code and the Council remains under-borrowed against its Capital Financing Requirement (CFR) at 31 March 2019.

6 INVESTMENT STRATEGY

6.1 The Investment Objectives and Policy states that 'the Council will aim to achieve the optimum return on its investments corresponding with proper levels of security and liquidity'.

6.2 The current Sector Limit for Money Market Funds (AAA) is £20m, with an individual Counterparty Limit of £5m for AAA rated Money Market Funds.

6.3 Due to high levels of cash held at certain times of the year, the £20m limit on money Market Funds are fully used and excess funds are placed with the DMO. The rates available from DMO are less than the Money Market Funds.

6.4 To be able to achieve an optimal return would require a 5th Money Market Fund, and an increase in the Sector Limit to £25m. It is recommended that this change is made to the current Treasury Strategy.

7 IMPLICATIONS

7.1 Financial

There are no further financial implications relating to this report. The outcomes from the Council's treasury management activities are explained in detail within Appendix 1.

7.2 Risk and Mitigations

This report is an account of the outcomes arising from the tightly controlled risk management work that the Council's Treasury staff have carried out. The report is an important element of the overall risk management environment but has no specific risk implications of its own.

7.3 Equalities

It is anticipated that there are no adverse impact due to race, disability, gender, age, sexual orientation or religion/belief arising from the proposals in this report.

7.4 Acting Sustainably

There are no direct economic, social or environmental issues with this report which would affect the Council's sustainability policy.

7.5 Carbon Management

There are no direct carbon emissions impacts as a result of this report.

7.6 Rural Proofing

It is anticipated there will be no adverse impact on the rural area from the proposals contained in this report.

7.7 Changes to Scheme of Administration or Scheme of Delegation

No changes to the Scheme of Administration or Scheme of Delegation are required as a result of this report.

8 CONSULTATION

8.1 The Service Director Regulatory Services as Monitoring Officer, the Chief Legal Officer, the Chief Officer Audit and Risk, the Chief Officer HR, Communications and the Clerk to the Council have been consulted and their comments incorporated into the report.

Approved by

David Robertson **Signature ....**
Chief Financial Officer

Author(s)

Name	Designation and Contact Number
Kirsty Robb Sara Halliday	Pension & Investment Manager, 01835 825249 Treasury Business Partner, 01835 824000 ext 5854

Background Papers:
Previous Minute Reference: Scottish Borders Council 20 February 2018 and 29 November 2018.

Note – You can get this document on tape, in Braille, large print and various computer formats by contacting the address below. The Pension and Investment Team can also give information on other language translations as well as providing additional copies.

Contact us at Pension and Investment Team, Council Headquarters, Newtown St Boswells, Melrose, TD6 0SA Tel: 01835 825249 Fax 01835 825166. email: T&Cteam@scotborders.gov.uk

APPENDIX 1

SCOTTISH BORDERS COUNCIL

ANNUAL TREASURY MANAGEMENT REPORT YEAR TO 31 MARCH 2019

CONTENTS

1. EXECUTIVE SUMMARY

1.1 This Council is required by regulations issued under the Local Government in Scotland Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2018/19. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

This paper highlights activity in relation to the treasury management function during 2018/19, the Council's strategy with regard to interest rates and future expectations and how the capital expenditure incurred by the Council in 2018/19 was funded. The investment strategy for 2018/19 is summarised in Section 5 and Members are provided with details of how well the treasury function has performed in relation to a set of standard performance indicators.

1.2 During 2018/19, the Council complied with its legislative and regulatory requirements.

1.3 Key Prudential (PI) and Treasury Management Indicators (TI), detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Table 1	**2018/19 Actual £m**	**2018/19 Estimate* £m**	**Variance £m**
Actual Capital Expenditure *(PI-1)*	**47.8**	**54.9**	**(7.1)**
Total Capital Financing Requirement (CFR) ** *(PI-2)*	**315.2**	**316.4**	**(1.2)**
(Under)/Over Gross Borrowing against the CFR *(PI-6)* ***	**(109.2)**	**(51.8)**	**(57.4)**

** Revised estimate, approved by Scottish Borders Council on 29 November 2018 as part of the Mid Year Treasury report 2018/19*
*** The CFR for this calculation includes current capital expenditure to 31 March 2019*
**** The CFR for this calculation includes the current and two future years projected capital expenditure.*

1.4 Additional borrowing for the purpose of debt rescheduling was undertaken during 2018/19 amounting to £10m. The statutory borrowing limit (the authorised limit) was not breached.

1.5 The economic environment during the 2018/19 financial year continued to remain challenging, with low investment returns.

2. COUNCIL'S CAPITAL EXPENDITURE AND FINANCING 2018/19

2.1 CAPITAL EXPENDITURE *(Prudential Indicator 1)*

a) The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need, or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

b) The final capital expenditure for 2018/19 was lower than projected as a result of delays in expenditure on a number of projects, including Hawick Flood Protection (£0.6m), A72 Dirtpot Corner £0.8m, New Easter Langlee Waste Transfer Station £0.9m, IT Transformation (£1.3m), Early Learning and Childcare £3.5m, Jedburgh Intergenerational Campus £1.4m, School Estate block £3.0m and the Great Tapestry of Scotland £1.0m.

The specific drivers for each of the movements have been disclosed in the regular monitoring reports to the Executive throughout 2018/19 and in the out-turn report presented on 4 June 2019.

2.2 FINANCING THE CAPITAL PROGRAMME

a) Capital Expenditure may either be financed:

(i) Immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which does not impact on the Council's borrowing need, or

(ii) If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

b) **Table 2** below summarises the main funding elements of the 2018/19 capital expenditure.

Table 2	**2018/19 Actual £m**	**2018/19 Estimate £m**	**Variance £m**
Capital Expenditure	47.8	54.9	(7.1)
Other Relevant Expenditure *	0.0	0.4	(0.0)
Total Expenditure	**47.8**	**55.3**	**(7.5)**
Financed by:			
Capital Grants & Other Contributions	24.6	29.5	4.9
SBC Revenue Funding	2.0	0.4	(1.6)
Capital Fund/Capital Receipts	1.2	2.3	1.1
Plant & Vehicle Fund	1.4	2.8	1.4
Total identified finance	**29.2**	**35.0**	**5.8**
Net Financing Need for the Year	**18.6**	**20.3**	**(1.7)**

The decrease in unfinanced capital expenditure compared with the estimate in the mid-year report resulted principally from timing movements as detailed in paragraph 2.1 b).

2.3 CAPITAL FINANCING REQUIREMENT AND EXTERNAL DEBT *(Prudential Indicators 2 and 5)*

a) The Council's underlying need to borrow for capital expenditure is termed the **Capital Financing Requirement (CFR)** and is a key prudential indicator. The CFR results from the capital activity of the Council and the resources that have been used to pay for the capital spend. It represents the 2018/19 unfinanced capital expenditure (see **Table 2** in section 2.2 (b)), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

b) Depending on the capital expenditure programme, the treasury function organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies, such as the Public Works Loan Board or the money markets, or utilising cash resources within the Council.

c) **Reducing the CFR** – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the scheduled debt amortisation (or loans fund repayment), to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR. The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the scheduled debt amortisation for loans repayment.

The Council's borrowing activity is constrained by prudential indicators, including those comparing gross borrowing, the CFR and the authorised limit.

d) The extent to which the Council is under/over borrowed at 31 March 2019 is calculated by comparing actual external debt against the CFR and is shown in **Table 3** below. It includes "Other long term liabilities", such as PFI and leasing schemes on the balance sheet. These increase the Council's borrowing need, however, as no borrowing is actually required against these schemes, these amounts have been deducted in **Table 3**.

Table 3	31 March 2019 Actual £m	31 March 2019 Estimate £m	Variance £m
CFR (PI-2)*	315.2	316.4	(1.2)
Less: Other long term liabilities **	70.4	68.0	2.4
Underlying borrowing requirement	244.8	248.4	(3.6)
External Borrowing at 31/3/19	195.2	208.7	13.5
(Under)/Over borrowing	(49.6)	(39.7)	9.9

**The CFR for this calculation includes current capital expenditure to 31 March 2019*
***PPP/PFI/Finance Lease balances*

TREASURY MANAGEMENT ACTIVITY

3.1 GROSS BORROWING AND THE CFR *(Prudential Indicator 6)*

a) In order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the current year (2018/19) plus the estimates of any additional capital financing requirement for the next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2018/19. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

Table 4	**31 March 2019 Actual £m**	**31 March 2019 Estimate £m**	**Variance £m**
Fixed rate funding			
PWLB	159.6	165.1	(5.5)
Market	-	-	-
Variable rate funding			
Market *	35.6	43.6	(8.0)
External Borrowing	**195.2**	**208.7**	**(13.5)**
Other long term liabilities **	70.4	68.0	2.4
Total Debt	**265.6**	**276.7**	**(11.1)**
CFR (inc. next 2 year estimates)	374.8	328.6	46.2
(Under)/Over Gross Borrowing against the CFR *(PI-6)*	**(109.2)**	**(51.9)**	**57.3**

* *LOBO loans (where a rate change could be instigated by the lender at certain intervals)*
** *PPP/PFI/Finance Lease balances*

b) Council deposits were made on a short term basis throughout 2018/19.

c) On 7 December 2018 the Council repaid £8m with an annual rate of 4.80% and breakage costs of £2.8m. These loans were replaced with £10m at 2.74%. As a result, net savings of £1.3m will be made to the General Fund over the 30 year term of the loan.

3.2 OPERATIONAL BOUNDARY AND AUTHORISED LIMIT *(Prudential Indicators 7 and 8)*

a) The **Operational Boundary** and the **Authorised Limit** are indicators which are intended to act as limits to the overall level of borrowing activity. The Authorised Limit represents the maximum limit beyond which borrowing is prohibited. The Operational Boundary represents the level of external borrowing that the Council is expected to operate within. **Table 5** compares the External Debt position with these indicators and demonstrates that the Council has not breached either limit during 2018/19.

Table 5	**31 March 2019 Actual £m**	**Authorised Limit** *(PI-8)* **£m**	**Variance £m**	**Operational Boundary** *(PI-7)* **£m**	**Variance £m**
Total Gross Borrowing	**265.6**	**401.9**	**(136.3)**	**312.3**	**(46.7)**

3.3 MATURITY PROFILE OF EXTERNAL DEBT

a) **Table 6** presents an analysis of the maturity structure of the Council's external debt portfolio.

Table 6	31 March 2019 £m
Under 12 months	7.5
12 months and within 5 years	5.9
5 years and within 10 years	25.9
Over 10 years	155.9
Total	**195.2**

4. INTEREST RATE MOVEMENTS AND EXPECTATIONS

4.1 THE ECONOMY AND INTEREST RATES – 2018/19

a) **UK.** After weak **economic growth** of only 0.2% in quarter one of 2018, growth picked up to 0.4% in quarter 2 and to a particularly strong 0.7% in quarter 3, before cooling off to 0.2% in the final quarter. Given all the uncertainties over Brexit, this weak growth in the final quarter was as to be expected. However, some recovery in the rate of growth is expected going forward. The annual growth in Q4 came in at 1.4% y/y confirming that the UK was the third fastest growing country in the G7 in quarter 4.

b) After the Monetary Policy Committee raised **Bank Rate** from 0.5% to 0.75% in August 2018, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the MPC until the uncertainties over Brexit clear. If there were a disorderly exit, it is likely that Bank Rate would be cut to support growth. Nevertheless, the MPC has been having increasing concerns over the trend in **wage inflation** which peaked at a new post financial crisis high of 3.5%, (excluding bonuses), in the three months to December before falling only marginally to 3.4% in the three months to January. British employers ramped up their hiring at the fastest pace in more than three years in the three months to January as the country's labour market defied the broader weakness in the overall economy as Brexit approached. The number of people in work surged by 222,000, helping to push down the unemployment rate to 3.9 percent, its lowest rate since 1975. Correspondingly, the total level of vacancies has risen to new highs.

c) As for **CPI inflation** itself, this has been on a falling trend since peaking at 3.1% in November 2017, reaching a new low of 1.8% in January 2019 before rising marginally to 1.9% in February. However, in the February 2019 Bank of England Inflation Report, the latest forecast for inflation over both the two and three year time horizons remained marginally above the MPC's target of 2%.

d) The rise in wage inflation and fall in CPI inflation is good news for consumers as their spending power is improving in this scenario as the difference between the two figures is now around 1.5%, i.e. a real terms increase. Given 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.

e) The comparison of the annual *average* percentage interest rates to projections within the 2018/19 strategy is set out in **Table 7** below.

Table 7	Bank Rate	PWLB Rates %		
	%	5 year	25 year	50 year
2018/19 Estimate	0.75	1.80	3.10	2.90
2018/19 Actual	0.63	1.50	2.66	2.47
Variance	**0.12**	**(0.30)**	**(0.44)**	**(0.43)**

4.2 BORROWING RATES IN 2018/19

a) During 2018-19, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

b) A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

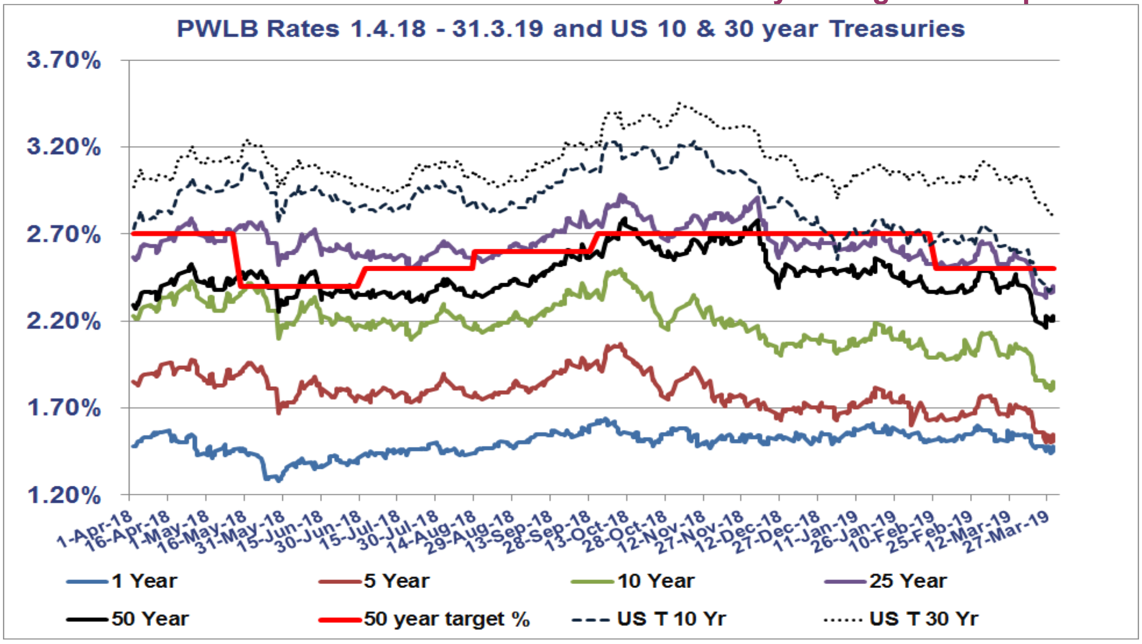
c) The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

d) Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Director of Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks (please adapt this outline to what you actually did in the year):

- if it had been felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.
- if it had been felt that there was a significant risk of a much sharper RISE in long and short term rates than initially expected, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

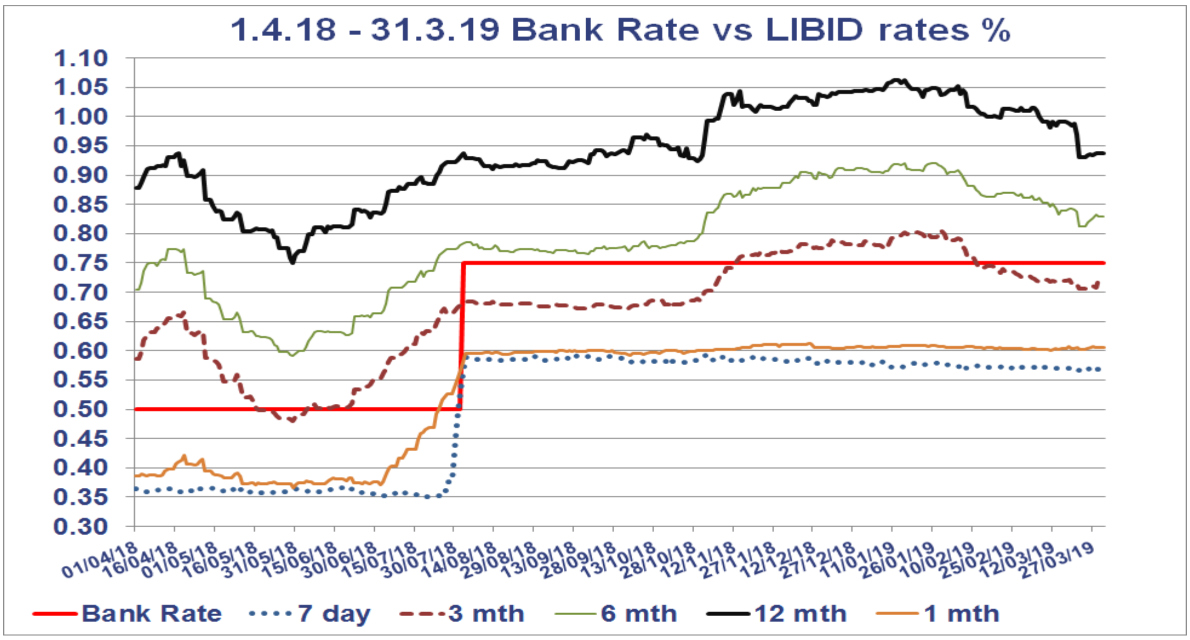
e) Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2018/19 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

Link Asset Services Interest Rate View 7.11.17														
	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB Rate	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%



f) Since PWLB rates peaked during October 2018, most PWLB rates have been on a general downward trend, though longer term rates did spike upwards again during December, and, (apart from the 1 year rate), reached lows for the year at the end of March. There was a significant level of correlation between movements in US Treasury yields and UK gilt yields -which determine PWLB rates. The Fed in America increased the Fed Rate four times in 2018, making nine increases in all in this cycle, to reach 2.25% – 2.50% in December. However, it had been giving forward guidance that rates could go up to nearly 3.50%. These rate increases and guidance caused Treasury yields to also move up. However financial markets considered by December 2018, that the Fed had gone too far, and discounted its expectations of further increases. Since then, the Fed has also come round to the view that there are probably going to be no more increases in this cycle. The issue now is how many cuts in the Fed Rate there will be and how soon, in order to support economic growth in the US. But weak growth now also looks to be the outlook for China and the EU so this will mean that world growth as a whole will be weak. Treasury yields have therefore fallen sharply during 2019 and gilt yields / PWLB rates have also fallen.

4.3 INVESTMENT RATES IN 2018/19



a) Investment returns remained low during 2018/19. The expectation for interest rates within the treasury management strategy for 2018/19 was that Bank Rate would rise from 0.50% to 0.75%. At the start of 2018-19, and after UK GDP growth had proved disappointingly weak in the first few months of 2018, the expectation for the timing of this increase was pushed back from May to August 2018. Investment interest rates were therefore on a gently rising trend in the first half of the year after April, in anticipation that the MPC would raise Bank Rate in August. This duly happened at the MPC meeting on 2 August 2018. During this period, investments were, therefore, kept shorter term in anticipation that rates would be higher later in the year.

b) It was not expected that the MPC would raise Bank Rate again during 2018-19 after August in view of the fact that the UK was entering into a time of major uncertainty with Brexit due in March 2019. Value was therefore sought by placing longer term investments after 2 August where cash balances were sufficient to allow this.

c) Investment rates were little changed during August to October but rose sharply after the MPC meeting of 1 November was unexpectedly hawkish about their perception of building inflationary pressures, particularly from rising wages. However, weak GDP growth data after December, plus increasing concerns generated by Brexit, resulted in investment rates falling back again.

d) Continued uncertainty in the aftermath of the 2008 financial crisis has promoted a cautious approach whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

5. INVESTMENT STRATEGY FOR 2018/19

5.1 INVESTMENT OBJECTIVES

a) The Council’s investment strategy is governed by Scottish Government investment regulations and sets out the approach for choosing investment categories and counterparties, based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc).

b) The **primary objectives** of the Council’s investment strategy are:
   (i) the safeguarding or **security** of the repayment of the principal and interest of investments on a timely basis;
   (ii) ensuring adequate **liquidity** within the Council; and
   (iii) maximising investment **yield** or return.

c) The Council will ensure:
   (i) It maintains a policy covering the categories of investment types it will invest in, the criteria for choosing investment counterparties with adequate security, and the monitoring of their security; and
   (ii) It has sufficient liquidity in its investments. For this purpose it sets out procedures for determining the maximum periods for which funds may prudently be committed. The Council’s Prudential Indicators cover the maximum period over which sums can be invested.

5.2 INVESTMENT ACTIVITY

a) The investment activity during the year conformed to the above approved strategy, and the Council had no liquidity difficulties. All money deposited with the Council's bank, Bank of Scotland, was done on an overnight basis to minimise security and liquidity risk to the Council.

5.3 CURRENT INVESTMENT POSITION

a) The total value of investments/deposits for the Council at 31 March 2019 was £2.7m. Cash was held on a short term basis throughout 2018/19 with major banks and various money market funds (the latter having a credit rating of AAA).

6 TREASURY PERFORMANCE INDICATORS

The Treasury Management Function has established the following additional performance indicators.

6.1 DEBT PERFORMANCE INDICATORS

These indicators are additional to the prudential & treasury management indicators covered earlier in this report. The Indicators are:

a) **Average 'Pool Rate'** charged by the Loans Fund compared to Scottish Local Authority average Pool Rate. Target is to be at or below the Scottish Average for 2018/19.

The Council's loans fund pool rate for 2018/19 was 4.07%. The Scottish Local Authority average "pool rate" for 2018/19 is not yet available at the time of writing, but was 3.99% in 2017/18 and is not expected to be materially different for 2018/19.

b) **Average rate movement year on year**. Target is to maintain or reduce the average borrowing rate for the Council versus 2017/18. The Council's pool rate of 4.07% for 2018/19 was 0.10% higher than the reported Council's rate of 2017/18.

6.2 INVESTMENT PERFORMANCE INDICATORS

a) Security

(i) The Council's maximum security risk benchmark for the current portfolio, when compared to historic default tables, is 0.02% historic risk of default.

(ii) During 2018/19, money was deposited in accounts on a short term basis, not exceeding 3 months.

b) Liquidity

(i) Liquid short term deposits should be at least £3,000,000, available with a week's notice.

(ii) This indicator was adhered to in 2018/19

(iii) Weighted Average Life benchmark is **expected to be 0.5 years** (equivalent to a weighted average life of 6 months), with a **maximum of 1.00 years.**

(iv) The weighted **average life for 2018/19 was 0.01 years**, well below the 0.5 year target.

c) Yield

The target yield is to have internal returns on cash investment above the 7 day LIBID rate. The return for 2018/19 averaged 0.57%, compared against an average 7 day LIBID rate for the year to 31 March 2019 of 0.51%.

2017/18 comparison figures for average internal returns and 7 day LIBID were 0.26% and 0.22% respectively.

Although yields remain low, the Council continues to make deposits on a short term basis with the Government's Debt Management Office (DMO) and Money Market Funds. The DMO is a very secure (Credit Rating of AAA) form of investment, but delivers a low rate of return (0.50%). The Money Market Funds used for deposits are also secure (with a Credit Rating of AAA). The planned deposit allocation between these two investment types has resulted in the returns mentioned above.

6.3 IMPACT ON REVENUE BUDGET

a) **Ratio of actual financing costs to net revenue stream** *(Prudential Indicator 3)*
This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue funding for the Council. The comparison of the revised estimate approved in the 2018/19 mid year report to the outturn as at 31 March 2019 is as follows:

Table 8	**Actual**	**Estimate**
Ratio of financing costs to net revenue stream *(PI-3)*	**%** **9.3**	**%** **9.0**

b) **Net Cost of Servicing Debt (Loan Charges) – Table 9** below summarises the comparison of the outturn versus estimate for the revenue cost of servicing the debt for the Council, including interest relating to PPP schools unitary charges.

Table 9	**2018/19 Outturn £m**	**2018/19 Mid-Year Estimate £m**	**Variance (Under) /Over £m**
Interest on Borrowing	12.9	12.8	0.1
Investment Income	(0.3)	(0.3)	-
Capital Repayments	8.5	8.4	0.1
Total Loan Charges	**21.1**	**20.9**	**0.2**

(i) The interest on borrowing costs represents the interest paid on external debt and to internally managed funds (e.g. Pension Fund, Common Good Funds).

6.4 TREASURY MANAGEMENT INDICATORS *(Treasury Indicators 1 – 5)*

a) The Treasury Indicators (TIs) are shown in **Table 10** below. The Council remained well within these Indicator limits throughout 2018/19

Table 10	**2018/19 Revised Indicator**		**2018/19 Actual as at 31 March 2019**
Upper limits – Debt with fixed and variable interest rates			
Upper limits on fixed interest rates *(TI-1)*	309.1		312.3
Upper limits on variable interest rates *(TI-2)*	108.2		109.3
Maturity Structure of borrowing			
	Upper *(TI-3)*	**Lower** *(TI-4)*	**Actual**
Under 12 months	20%	0%	3.84%
12 months to 2 years	20%	0%	0.39%
2 years to 5 years	20%	0%	2.63%
5 years to 10 years	20%	0%	13.26%
10 years and above	100%	20%	79.88%
Prudential limits for principal sums invested *(TI-5)*			
Cash Deposits < 12 months	100%		100%
Cash Deposits > 12 months	20%		0%

ANNEX A

Indicator Reference	Indicator	Page Ref.	2018/19 Original estimate	2018/19 Revised estimate	2018/19 Actual
PRUDENTIAL INDICATORS					
Capital Expenditure Indicator					
PI-1	Capital Expenditure (£m)	3	43.9	54.9	47.8
PI-2	Capital Financing Requirement (£m) (CFR)	5	322.1	316.4	315.2
Affordability Indicator					
PI-3	Ratio of Financing Costs to Net Revenue	12	9.5%	9.0%	9.3%
PI-4	Incremental Impact of Capital Investment Decisions on Council Tax	N/A	£0.00	£0.00	£(0.04)
External Debt Indicators					
PI-5	Actual Debt (£m)	6	286.4	276.7	265.6
PI-7a	Operational Boundary (inc. Other Long Term Liabilities) (£m)	6	308.2	309.1	312.3
PI-7b	Operational Boundary (exc. Other Long Term Liabilities) (£m)	6	237.5	241.1	241.9
PI-8a	Authorised Limit (inc. Other Long Term Liabilities) (£m)	6	372.7	372.1	401.9
PI-8b	Authorised Limit (exc. Other Long Term Liabilities) (£m)	6	302.0	304.1	331.6
Indicators of Prudence					
PI-6	(Under)/Over Gross Borrowing against the CFR (£m)	6	(70.3)	(51.8)	(109.2)
TREASURY INDICATORS					
TI-1	Upper Limit to Fixed Interest Rates based on Net Debt (£m)	13	308.2	309.1	312.3
TI-2	Upper Limit to Variable Interest Rates based on Net Debt (£m)	13	107.9	108.2	109.3
TI-3 & TI-4	Maturity Structure of Fixed Interest Rate Borrowing	13	**Upper**	**Lower**	
	Under 12 months		20%	0%	
	12 months to 2 years		20%	0%	
	2 years to 5 years		20%	0%	
	5 years to 10 years		20%	0%	
	10 years and above		100%	20%	
TI-5	Maximum Principal Sum invested greater than 364 days	13	20%	20%	20%