Appendix 1

Mid Year Monitoring Report 2018/19
Treasury Management and Prudential Indicators: 1 April 2018 to 31 October 2018

1. Introduction

1.1 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government in Scotland Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;

- The Act permits the Scottish Ministers to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions have been made as yet during 2018/19).

- Statutory Instrument (SSI) 29 2004, requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities, and therefore to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services; and the treasury activity with regard to the CIPFA Code of Practice for Treasury Management in Local Authorities.

- Statutory Instrument (SSI) 123 2016, set out statutory arrangements for local authority borrowing and lending and the requirement to maintain a loans fund and replace the statutory arrangements set out in Schedule 3 of the Local Government (Scotland) Act 1975 (Schedule 3).

1.2 The regulatory framework of treasury management requires that the Council receive a mid year treasury review, in addition to the forward looking annual treasury strategy and backward looking annual treasury report required previously. This report meets that requirement and also incorporates the needs of the Prudential Code to ensure adequate monitoring of the capital expenditure plans and the Council's prudential indicators. The treasury strategy and prudential indicators were previously reported to Council on 5 March 2018. The current position is shown (where appropriate) and revisions to the 2018/19 estimate are provided where required.

1.3 In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities will be required to prepare a Capital Strategy which is intended to provide the following:

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;

- an overview of how the associated risk is managed; and

- the implications for future financial sustainability

The Capital Strategy of the Council will be reported to Council on 27 March 2019.

1.4 This report sets out:

- Key changes to the Council's capital activity (the prudential indicators);
- Policy on the statutory repayment of loans fund advances;
- An economic update for the first part of the 2018/19 financial year;
- The actual and proposed treasury management activity (borrowing and investment);
- The risk approach to treasury management (the treasury management indicators); and
- Policy on ethical investments

2. Key Prudential Indicators

2.1 This part of the report is structured to update:

- The Council's capital expenditure plans and how these plans are being financed;
- The impact of the changes in the capital expenditure plans on the PIs and the underlying need to borrow;
- Compliance with the limits in place for borrowing activity; and
- Policy on the statutory repayment of loans fund advances

2.2 **Capital Expenditure** – Table A shows the current position and revised estimates for capital expenditure for 2018/19 only.

Table A:

£000	2018/19 Original Estimate	Current Position	2018/19 Projected Outturn
General Services	73,082	15,022	59,835
HRA	32,326	10,135	26,814
Capital Expenditure	**105,408**	**25,157**	**86,648**
Financed by:			
Capital receipts	10,905	18	10,094
Capital grants	28,504	9,498	30,689
Revenue	7,783	0	7,704
Net financing need for the year	**58,216**	**15,642**	**38,162**

2.2.1 The reduction in the both the level of anticipated capital expenditure and the net financing need for the year is due to ongoing forecast outturn figures for both the General Services and Housing Revenue Account capital plans. These anticipated spends and resourcing required are regularly reported to Members through budgetary control reports.

2.3 **Impact of changes in Capital Expenditure Plans** – Table B shows the CFR, which is the underlying external need to borrow for a capital purpose while Table C shows the expected debt position over the period.

Table B:

£000	**2018/19 Original Estimate**	**2018/19 Projected Outturn**
Opening CFR	**485,889**	**514,349**
New Borrowing – CFR	48,084	27,818
LTL repayment in year	(1,946)	(2,713)
Closing CFR	**532,026**	**539,454**
Movement in CFR (from Previous year)	46,138	25,105

Net financing need for the year (Table A)	58,216	38,162
Loan repayments in year	(10,132)	(10,345)
New Borrowing – CFR	**48,084**	**27,818**

Table C:

£000	**2018/19 Original Estimate**	**Current Position**	**2018/19 Projected Outturn**
External Debt			
Estimated/Actual Debt at 1 April 2018	403,295	425,291	425,291
Maturing Debt	(166,650)	(152,196)	(185,560)
<u>Movement in Borrowing</u>			
New Borrowing - Maturing Debt	166,650	143,650	185,560
Borrowing adjustment in relation to over borrowing at year end	0	0	(16,856)
New Borrowing – CFR (Table B)	48,084	0	27,818
Debt at 31 March (1)	**451,379**	**416,745**	**436,253**
Long Term Liabilities (LTL) at 1 April	82,160	105,914	105,914
LTL repayment in year (Table B)	(1,946)	(1,598)	(2,713)
LTL at 31 March (2)	**80,214**	**104,316**	**103,201**

Actual Debt at 31 March (1) + (2)	**531,593**	**521,061**	**539,454**
CFR from Table B	**532,026**	**n/a**	**539,454**
Under/(Over) Borrowing	**(433)**	**n/a**	**0**

2.3.1 The external debt figures included within Table C now includes both short term and long term debt. This change has been made due to a strategy of using short term borrowing to fund long term capital investment enabling the Council to take advantage of lower interest rates. The reduction in the estimated external debt for 2018/19 is due to a reduction in the net capital financing need for the year.

2.3.2 The CFR is calculated on a year end position based on the Council's balance sheet and therefore the current position is not shown. The CFR has reduced from the original estimate due to the forecast level of capital expenditure in 2018/19 being less than budgeted. The Strategic Lead - Resources can report that the Council is on target to meet the 2018/19 revised estimates for both indicators.

2.3.3 Table C highlights that the borrowing of the Council is forecast to be equal to the CFR at 31 March 2019.

2.4 **Compliance with the limits in place for borrowing activity** – A key control over the treasury activity is a prudential indicator to ensure that over the medium term, gross borrowing will only be for a capital purpose.

Gross borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and next two financial years. This allows some flexibility for limited early borrowing for future years.

The Council has approved a policy for borrowing in advance of need which will be adhered to if this proves prudent. As discussed in section 2.3, above the current position is not shown since the CFR is calculated on a year end position. The revised indicator is detailed in Table D and is illustrated by comparing the estimated gross debt as at 31 March 2019 with the CFR as at 31 March 2021. The Strategic Lead - Resources reports that no difficulties are envisaged for the current year in complying with this prudential indicator.

Table D:

£000	**2018/19 Original Estimate**	**2018/19 Projected Outturn**
CFR at 31 March 2018		
2017/18 Estimate/Actual (From Table B above)	**485,889**	**514,349**
Estimated movement in CFR		
2018/19 (From Table B above)	46,138	25,105
2019/20	46,941	77,412
2020/21	48,314	50,587
Anticipated CFR at 31 March 2021	**627,282**	**667,454**
Gross Debt at 31 March 2019 (From Table C above)	**531,593**	**539,454**

2.4.1 The Operational Boundary is detailed in Table E below and is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Table E:

£000	**2018/19 Original Estimate**	**Current Position**	**2018/19 Projected Outturn**
External Debt	584,752	573,167	593,399

2.4.2 A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which is detailed in Table F and represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Table F:

£000	2018/19 Original Estimate	Current Position	2018/19 Projected Outturn
External Debt	637,911	625,273	647,344

2.5 **Statutory repayment of loans fund advances** – The Council is required to set out its policy for the statutory repayment of loans fund advances. The repayment of loans fund advances ensures that the Council makes a prudent provision each year to pay off an element of the accumulated loans fund advances made in previous financial years.

2.5.1 A variety of options are provided to Councils so long as a prudent provision is made each year as detailed below:

- **Statutory method** – loans fund advances will be repaid by the annuity method (option 1). The Council is permitted to use this option for a transitional period only, of five years until 31 March 2021, at which time it must change its policy to use alternative approaches based on depreciation, asset life periods or a funding/income profile as detailed below;

- **Depreciation method** – annual repayment of loans fund advances will follow standard depreciation accounting procedures (option 2);

- **Asset life method** – loans fund advances will be repaid with reference to the life of an asset using either the equal instalment or annuity method (option 3); and

- **Funding / Income profile method** – loans fund advances will be repaid by reference to an associated income stream (option 4).

2.5.2 The policy for loans fund advances will be:

- For loans fund advances made before 1 April 2016, the policy will be to maintain the practice of previous years and apply the **Statutory Method** (option 1), with all loans fund advances being repaid by the annuity method.

- Recognising that the Council has forward capital expenditure plans, has already committed to that plan and the revenue implications of that plan, the policy for loans fund advances made from 1 April 2016 to 31 March

2021 the policy will be to apply the **Statutory Method** (option 1), with all loans fund advances being repaid by the annuity method.

- For loans fund advances made after 1 April 2021, the policy for the repayment of loans advances will be to apply the following options, selecting the most suitable method from the list below for each individual advance.

    - **Asset life method** – loans fund advances will be repaid with reference to the life of an asset using either the equal instalment or annuity method (option 3). It is likely that the equal instalment method will be used;

    - **Funding / Income profile method** – loans fund advances will be repaid by reference to an associated income stream (option 4).

3. Economic Outlook

3.1 The first half of 2018/19 has seen UK economic growth post a modest (but sufficiently robust) performance to unanimously vote to increase the Bank Rate on 2 August 2018 from 0.5% to 0.75%. Although growth looks as if it will only be modest 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. Inflation rose unexpectedly from 2.4% in June to 2.7% in August due to increases in volatile components, but is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate. The MPC has indicated Bank Rate would 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 in Bank Rate for the second half of 2019.

As for the labour market, unemployment has continued at a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high in July, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 2.9%. 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. This tends to confirm that the MPC were right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy. However, the MPC will need to tread cautiously before increasing Bank Rate again, especially given all the uncertainties around Brexit.

In the political arena, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, the central view of the Council's treasury advisors is that that Prime Minister May's government will endure, despite various setbacks, along the route to Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary policy leading to an increasing expectation of a weak pound and concerns around inflation picking up.

2.5 The Council's treasury advisor, Link Asset Services, has provided the following interest rate forecast.

Table G:

Link Asset Services Interest Rate View											
	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

4. Treasury Management Activity

4.1 This part of the report is structured to update:

- The Council's expected borrowing need and details of under/(over) borrowing;
- Debt rescheduling and new borrowing;
- Debt charges; and
- Investments

4.2 **The Expected Borrowing Need** – This was set out in Table C (above) and demonstrates that at 31 October 2018 Council is currently under-borrowed to reduce risks in investments held and the cost of carry on investments (investments yield up to 0.60%, long term borrowing rates for periods greater than 25 years are approximately 2.78%). This introduces an element of interest rate risk, as longer term borrowing rates may rise; however, this position is being carefully monitored.

4.3 **Debt rescheduling and new borrowing** – The Council has not undertaken any debt rescheduling during the first half of 2018/19. In the year to date naturally maturing debt of £152.196m has been repaid which has been mainly funded by loans from other local authorities.

4.4 **Debt Charges** – The revised estimate for debt charges for both the General Fund and the HRA is shown in Table H.

Table H:

£000	2018/19 Original Estimate	Current Position	2018/19 Revised Estimate
Borrowing	22,203	12,698	22,390
Other Long Term Liabilities	10,478	6,060	10,311
Total	**30,449**	**17,412**	**30,469**

4.5 **Investments** – The objectives of the Council's investment strategy are to ensure the re-payment of the principal and interest of its investments on time with the level of investment return being a secondary objective. Following on from the economic background above, the current investment climate has one over-riding risk consideration which is the risk of default.

4.5.1 The Council held £11.965m of cash investments at 31 October 2018, and the constituent parts of the investment position are detailed in Table I:

Table I:

£000	Country	< 1 Year	1 – 2 Years	2 – 3 Years
Banks	UK	965	Nil	Nil
Money Market Fund		11,000	Nil	Nil
Total		11,965	Nil	Nil

4.5.2 Table J details the revised budget position for investment income. The original estimate has increased by £0.061m.

Table J:

£000	2018/19 Original Estimate	Current Position	2018/19 Revised Estimate
Investment Income	57	69	118

4.5.3 A regulatory development to address risk is the consideration and approval of benchmarks relating to investment security, liquidity and the level of return. Benchmarks are currently widely used to assess the level of return and investment performance, however the application of security and liquidity benchmarks are more subjective in nature.

- **Security** - The Council's maximum security risk benchmark for the current portfolio in relation to investment periods of up to one year (when compared to historic default tables) was set at 0.09% and the Strategic Lead - Resources can report that there have been no defaults of principal sums invested in the year to date.

- **Liquidity** – The Strategic Lead - Resources can report that liquidity arrangements were adequate during the year to date and that the liquidity facilities and benchmarks set by the Council as noted below were maintained:

    - Bank overdraft - £1.000m; and
    - Liquid short term deposits of at least £5.000m available on an overnight basis.

- **Return on Investments** – The Strategic Lead - Resources can report that investment return to date average 0.60%. Table K illustrates how this average return compares with the local benchmarks approved in March 2018.

Table K:

Benchmark	Benchmark Return	Average Return
7 day LIBID rate	0.59%	0.60%
1 month LIBID rate	0.60%	0.60%
Council's Instant Access Account	0.75%	0.60%

4.5.4 Changes to Money Market Regulations came into force on 21 July 2018.

The Regulation provides investors with an option for investing their short-term cash in two types of Money Market Funds ("MMFs"):

- **Short-term MMFs** - Funds that maintain the existing conservative investment restrictions currently provided under the European Securities and Market Authorities (ESMA) with a maximum Weighted Average Maturity (WAM) of 60 days and maximum Weighted Average Life (WAL) of 120 days; and

- **Standard MMFs** – Funds that reflect the existing ESMA Money Market Fund definition with a maximum WAM of 6 months and maximum WAL of one year.

In addition, there are three structural options:

- **Public Debt Constant Net Asset Value** ("CNAV") MMFs - must invest 99.5% of their assets into government debt instruments and are permitted to maintain a constant dealing NAV. This Fund is already in existence and there is no change proposed to the current structure;

- **Low Volatility Net Asset Value** ("LVNAV") MMFs - permitted to maintain a constant dealing NAV provided that certain criteria are met, including that the market NAV of the Fund does not deviate from the dealing NAV by more than 20 basis points (bps); and

- **Variable Net Asset Value** ("VNAV") MMFs – Funds which price their assets using market pricing and therefore offer a fluctuating dealing NAV.

The Council currently invests in the following 4 money market funds which have indicated that they will convert from Constant Net Asset Value funds to Low Volatility Net Asset Value in January 2019. Conversion dates are shown in table L below.

Table L:

Money Market Fund	Current Classification	New Classification	Conversion Date
Blackrock	CNAV	LVNAV	14 January 2019
State Street Global Advisors	CNAV	LVNAV	January - TBC
Aberdeen Asset Management	CNAV	LVNAV	11 January 2019
Federated Investors	CNAV	LVNAV	11 January 2019

The changes to the money market regulations and the impact on those currently used by the Council require an update to the approved list of permitted investment as detailed below.

- **Cash Type Instruments**

  - Deposits with the Debt Management Account Facility (UK Government);
  - Deposits with other local authorities or public bodies;
  - Money Market Funds (both CNAV and LVNAV);
  - Call accounts, deposit accounts with financial institutions (banks and building societies;
  - Term deposits with financial institutions (banks and building societies);
  - UK Government Gilts and Treasury Bills;
  - Certificates of deposits will financial institutions (banks and building societies); and
  - Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates, etc.).

- **Other Investments**

  - Investment properties;
  - Loans to third parties, including soft loans;
  - Loans to a local authority company;
  - Shareholding in a local authority company;
  - Non-local authority shareholdings;
  - Joint venture delivery companies such as hub West Scotland;
  - Regeneration partnerships and development opportunities;
  - District Heating Schemes; and
  - Local Authority Mortgage Scheme (LAMS).

5 Key Treasury Management Indicators

5.1 This part of the report is structured to update:

- Actual and estimates of the ratio of financing costs to net revenue stream;
- Upper limits on interest rate exposure:
- The maturity structure of borrowing; and
- Total principal sums invested.

5.2 **Actual and estimates of the ratio of financing costs to net revenue stream** – This indicator (as shown below in Table M) identifies the trend in the cost of capital (financing costs net of interest and investment income) against the net revenue stream.

Both the General Fund and the HRA estimate have increased mainly due to higher borrowing costs as a result of the increase in the base rate that occurred in August 2018

Table M:

	2018/19 Original Estimate	2018/19 Revised Estimate
General Fund	8.71%	9.75%
HRA	26.01%	27.81%

5.3 **Upper Limits On Fixed and Variable Rate Exposure** – These indicators identify a maximum limit for fixed and variable interest rates based upon the debt position and were set at 100% and 50% respectively for 2018/19. The Strategic Lead – Resources reports that the Council operates within these limits.

5.4 **Maturity Structures Of Borrowing** – These maximum limits are set to reduce the Council's exposure to large fixed rate loans (those instruments which carry a fixed interest rate for the duration of the instrument) which are due to naturally mature in any given period as detailed in Table N and show that the Council operates within limits set.

Table N:

Maturity Structure of Fixed Interest Rate Borrowing	2018/19 Original LImits	Current Position
Under 12 months	50%	30.58%
12 months to 2 years	50%	14.81%
2 years to 5 years	50%	6.24%
5 years to 10 years	50%	3.56%
10 years to 20 years	50%	5.97%
20 years to 30 years	50%	4.59%
30 years to 40 years	50%	7.85%
40 years to 50 years	100%	12.34%
50 years to 60 years	100%	7.48%
60 years to 70 years	100%	0%

5.5 **Total Principal Funds Invested** – These limits are set to reduce the need to temporarily borrow to cover any unexpected expenditure, and show limits to be placed on investments with final maturities beyond each year-end. The Council currently invests sums for periods greater than 365 days in Clydebank Property Company and hub West Scotland as detailed in Table O.

Table O:

	2018/19 Original Estimate	Current Position	2018/19 Revised Estimate
Principal sums invested > 365 days (maximum limit £7m)	£0.501m	£0.497m	£0.497m

6 Ethical Investments

6.1 This is the placing of funds and selecting investments in a manner that reflects an authority's ethical values. Generally, two sets of criteria are drawn up – negative and positive values whereby investments are to be avoided or encouraged.

6.2 The following policy statement was approved on 25 October 2017:

6.2.1 The Council will not knowingly invest directly in organisations (including financial institutions and money market funds) whose activities and practices pose a risk of serious harm to individuals and/or groups, or whose activities are inconsistent with the Council's vision, values and priorties. This could include avoiding direct investment in organisations with material links to:

- Human rights abuse (e.g. child labour);
- Environmentally harmful activities (e.g. destruction of habitat); and
- Socially harmful activities (e.g. gambling)

6.2.2 In order to give effect to its commitment to this policy the Strategic Lead (Resources) contacted all investment counterparties on 9 January 2018 advising of our policy.

6.2.3 In accordance with the further commitments that were given in October 2017 it is considered that this policy statement remains relevant and does not require to be amended at this time.