

Corporate and Community Services Department

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Date: 15 February 2019

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TO: Councillors Stewart Miller (Chair), Barbara Grant (Vice-Chair), Provost Jim Fletcher, and Councillors Charlie Gilbert, Annette Ireland, Jim McLean and Jim Swift.

AUDIT AND SCRUTINY COMMITTEE

A meeting of the Audit and Scrutiny Committee will be held in the Council Chamber, Council Headquarters, Eastwood Park, Giffnock, on **Thursday, 21 February 2019 at 2.00 pm.**

Caroline Innes

C INNES
DEPUTY CHIEF EXECUTIVE

AGENDA

1. Report apologies for absence.
2. Declarations of interest.
3. Chair's Report.
4. Treasury Management Strategy Report for 2019/20 – Report by Head of Accountancy (Chief Financial Officer)(copy attached, pages 3 - 56).
5. Local External Audit Report on Housing Benefit Performance Audit Risk Assessment and National External Audit Report on Housing Benefit Performance Audit Annual Update 2017/18 - Report by Clerk (copy attached, pages 57 - 88).
6. National External Audit Report on European Union - Report by Clerk (copy attached, pages 89 - 96).

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EAST RENFREWSHIRE COUNCIL
AUDIT AND SCRUTINY COMMITTEE

21 February 2019

Report by Head of Accountancy (Chief Financial Officer)

Treasury Management Strategy Report for 2019/20

PURPOSE OF REPORT

1. To advise the Audit and Scrutiny Committee on the treasury management strategy for the financial year 2019/20.

RECOMMENDATIONS

2. It is recommended that Members:-
 - (a) consider the content of the Treasury Management Strategy Report for 2019/20; and
 - (b) recommend to the Council that the Treasury Management Strategy for 2019/20 be approved, including the amended list of organisations for investment of surplus funds (Annex F); and
 - (c) recommend to the Council that they approve the policy on the repayment of loans fund advances, see section 3.4

BACKGROUND

3. In line with the CIPFA Treasury Management Code of Practice 2011, the Audit and Scrutiny Committee is responsible for ensuring effective scrutiny of the treasury management strategy and policies.
4. The attached Treasury Management Strategy Report for the financial year 2019/20 is submitted in accordance with this requirement.

TREASURY MANAGEMENT STRATEGY FOR 2019/20 (TMS)

5. The TMS for 2019/20 is attached (see Appendix 1).

EQUALITY IMPACT

6. A screening exercise has revealed that the Treasury Management Strategy has no direct relevance to the Council's equality duties

Report Author

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Report Date: February 2019

Key Words

Treasury Management, Interest Rates, Treasury Strategy, investment, debt rescheduling, Prudential Indicators

APPENDIX 1

EAST RENFREWSHIRE COUNCIL

**TREASURY MANAGEMENT STRATEGY
2019/20**

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1 Background

The Council is required to operate a balanced budget, which broadly means that cash received during the year will meet cash expenditure. A major aspect of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, ensuring adequate liquidity before considering 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, being essentially longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

CIPFA defines treasury management as:

“The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

Revised reporting is required for the 2019/20 reporting cycle due to revisions of the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity if that is going to be undertaken. The capital strategy is being reported separately.

2 Reporting Requirements

2.1 The Council is required to receive and approve, as a minimum, three main reports on treasury activity each year, which incorporate a variety of policies, estimated and actual figures. These reports are as follows:-

a) **Treasury Management Strategy 2019/20** (this report).

This report is the most important of the three reports and covers:

- The capital plans of the Council (including prudential indicators);
- A policy for the statutory repayment of debt (how residual capital expenditure is charged to revenue over time);

- The Treasury Management Strategy (how the investments and borrowings are organised) including treasury indicators, and
 - A permitted investment strategy (the parameters on how investments are to be managed).
- b) **Mid-Year Treasury Management Report** – This is primarily a progress report and will update members on the progress of the capital position, amending prudential indicators as necessary and whether any policies require revision.
- c) **Annual Treasury Report** – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimate within the strategy.

2.2 Scrutiny

These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the Audit and Scrutiny Committee.

2.3 Capital Strategy

The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019-20, all local authorities to prepare an additional report, a capital strategy report, which will provide the following:

- A high-level long term 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
- the implications for future financial sustainability

The aim of this capital strategy is to ensure that all elected members fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

2.4 Treasury Management Strategy for 2019/20

The treasury management issues covered by this report are:

Capital Issues

- The capital expenditure plans and associated prudential indicators
- The loans fund repayment policy

Treasury management issues

- The current treasury position
- Treasury indicators which will limit the treasury risk and activities of the Council
- Prospects for interest rates
- The borrowing strategy
- Policy on borrowing in advance of need
- Debt rescheduling
- The investment strategy and

- Credit Worthiness Policy

These elements cover the requirements of the Local Government in Scotland Act 2003, the CIPFA Prudential Code (the Prudential Code), the CIPFA Treasury Management Code and Scottish Government Investment Regulations.

2.5 Treasury Management Consultants

The Council uses Link Asset Services Treasury Solutions as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that it does not rely solely upon information and advice from its treasury advisors.

It also recognises however that there is value in employing external providers of treasury management services in order to gain access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2.6 Council and Subsidiary Organisations

The Treasury Management Strategy covers the treasury management activities for the Council (including any subsidiary organisations i.e. East Renfrewshire Culture & Leisure Trust).

3 The Capital Prudential Indicators 2019/20 – 2023/24

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members to overview and confirm them.

A summary of the indicators can be found in Annex A

3.1 Capital Expenditure (Prudential Indicator PI-1)

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously and those forming part of this budget cycle. The indicator also includes expenditure financed by PFI and leasing type arrangements which, for the purposes of financial planning and reporting, must be treated as capital expenditure.

The following capital expenditure forecasts are in line with the general fund capital plan for 2019/20-2026/27 and housing capital plan 2019/20- 2023/24 which will be submitted to Council on 28 February 2019 together with the additional expenditure outlined above:

Capital Expenditure (PI-1) £'000	2017/18 Actual	2018/19 Probable	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
General Fund – Capital Programme	24,047	36,987	48,017	58,460	52,540	19,586	11,497
– Other Relevant Expenditure	22,307	-	-	-	-	-	-
General Fund Subtotal	46,354	36,987	48,017	58,460	52,540	19,586	11,497
Housing	5,496	9,539	10,969	10,320	13,693	12,167	4,874
Total	51,850	46,526	58,986	68,780	66,233	31,753	16,371

3.2 Capital Financing Assumptions

The table below summarises the capital expenditure plans for the general fund and how these plans are being financed. Any shortfall of resources results in a funding borrowing need.

General Fund £'000	2017/18 Actual	2018/19 Probable	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Capital Expenditure	24,047	36,987	48,017	58,460	52,540	19,586	11,497
Other Relevant Expenditure	22,307	-	-	-	-	-	-
Total	46,354	36,987	48,017	58,460	52,540	19,586	11,497
Financed by:							
Capital Receipts	194	1,810	3,450	1,350	600	-	-
Capital Reserve Developer Contributions	11,500	8,466	1,200	-	-	-	-
Govt. General Capital Grant	453	611	1,644	3,806	-	-	-
Govt. Specific Capital Grants	7,459	6,866	7,929	6,634	6,634	6,634	6,634
Other Grants & Contributions	23,467	7,577	6,883	4,779	12,600	1,440	-
Repairs & Renewals	296	235	75	75	75	75	75
Fund/CFCR	878	125	64	-	-	-	-
Net Borrowing Requirement for the year	2,107	11,297	26,772	41,816	32,631	11,437	4,788

As part of the long term capital planning process, the 2018/19 probable capital outturn has been reduced by £270,000 below the level reported to Cabinet on 6 December 2018. In addition the level and timing of capital receipts has increased by £2,415,000 due mainly to the receipt of additional grant during 2018/19, this therefore has impacted on the amount of borrowing required which has reduced by £2,685,000. These revisions will be incorporated within the 2018/19 monitoring report submitted to Cabinet during March 2019.

The table below summarises the capital expenditure plans for housing and how these plans are being financed. Any shortfall of resources results in a borrowing requirement.

Housing £'000	2017/18 Actual	2018/19 Probable	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Capital Expenditure	5,496	9,539	10,969	10,320	13,693	12,167	4,874
Financed by:							
Capital Receipts – Right to Buy	1,504	196	-	-	-	-	-
Capital Receipts – Land Disposal	-	-	-	500	500	500	500
Recharges to Owners	377	401	615	409	424	467	482
Govt. Specific Capital Grants	319	2,518	2,100	955	3,533	2,991	100
Commutated Sums	52	417	32	437	291	245	-
CFCR	500	-	-	-	-	-	-
Net Borrowing Requirement for the year	2,744	6,007	8,222	8,019	8,945	7,964	3,792

The table below summarises the borrowing requirement resulting from both the general fund (including PFI and leasing type arrangements) and housing capital plans.

Borrowing Requirement £'000	2017/18 Actual	2018/19 Probable	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
General Fund	2,107	11,297	26,772	41,816	32,631	11,437	4,788
Housing	2,744	6,007	8,222	8,019	8,945	7,964	3,792
Net Borrowing Requirement for the year	4,851	17,304	34,994	49,835	41,576	19,401	8,580

3.3 The Council's Borrowing Requirement (the Capital Financing Requirement – Prudential Indicator PI-2)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure identified above, which has not immediately been paid for (e.g. via grants), will increase the CFR.

The CFR does not increase indefinitely, as prudent annual repayments from revenue need to be made which reflect the useful life of capital assets financed by borrowing. From 1 April 2016 authorities may choose whether to use scheduled debt amortisation (loans pool charges) or another suitable method of calculation in order to repay borrowing.

The CFR includes any other long term liabilities (e.g. PPP schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes. The Council has liabilities of £94.789m relating to such schemes as at 31 March 2018.

The Council is asked to approve the CFR projections below:

Capital Financing Requirement (PI-2) £'000	2017/18 Actual	2018/19 Probable	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
General Fund Housing	166,648 26,587	166,923 29,585	182,043 34,590	212,456 39,110	231,813 44,649	227,551 49,040	215,635 49,097
Total CFR (PI-2)*	193,235	196,508	216,633	251,566	276,462	276,591	264,732

Net borrowing requirement for the year (above)		17,304	34,994	49,835	41,576	19,401	8,580
Less scheduled debt amortisation and other financing movements		(14,031)	(14,869)	(14,902)	(16,680)	(19,272)	(20,439)
Movement in CFR		3,273	20,125	34,933	24,896	129	(11,859)

*The CFR for this calculation includes capital expenditure to 31 March of each financial year.

3.4 Statutory Repayment of Loans Fund Advances

The Council is required to set out its policy for the statutory repayment of loans fund advances prior to the start of the financial year. 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.

A variety of options are provided to Councils so long as a prudent provision is made each year. The Council is recommended to approve the following policy on the repayment of loans fund advances:-

- 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 (in line with Schedule 3 of the Local Government (Scotland) Act 1975), with all loans fund advances being repaid by the annuity method in line with the repayment profile determined in previous years.
- Loans fund advances relating to City Deal projects which will be supported in later years by Government funding will be repaid in accordance with the funding/income profile method. This links the repayments to the project income stream.
- For loans fund advances made after 1 April 2016, excluding the above, the Council will continue to calculate loan charge repayments in line with Schedule 3 of the Local Government (Scotland) Act 1975, using an annuity rate of 4%. This rate is in keeping with the estimated loans fund rate for 2018/19 to 2021/22. The Council is permitted to use this option for new borrowing taken out over a transitional period of five years until 31 March 2021. Thereafter a new policy approach based on depreciation, asset life periods or funding/income profile must be adopted for any further new borrowing.

However, the Scottish Government are currently reviewing legislation which will allow Council's to vary loans fund repayments for advances made before 1 April 2016. Changes to repayments must be based on prudent principles. Once details of this new flexibility are available, Accountancy services will review the Council's loans fund and report to Council any planned changes to the repayment's schedule.

The Non-HRA loans fund balances are expected to be, with year 1 being 2018/19:

£'000	Year 1	Years 2-5	Years 5-10	Years 10-15	Years 15-20	Years 20+
opening balance	71,861	76,445	155,861	113,848	63,078	35,805
advances	11,297	101,219	18,504	-	-	-
repayments	6,713	21,803	60,517	50,770	27,273	35,805
closing balance	76,445	155,861	113,848	63,078	35,805	-

The HRA loans fund balances are expected to be, with year 1 being 2018/19:

£'000	Year 1	Years 2-5	Years 5-10	Years 10-15	Years 15-20	Years 20+
opening balance	26,587	29,585	44,649	38,685	26,903	15,888
advances	6,007	25,186	11,756	-	-	-
repayments	3,009	10,122	17,720	11,782	11,015	15,888
closing balance	29,585	44,649	38,685	26,903	15,888	-

4 Borrowing

Section 3 provides a summary of the capital expenditure plans. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional Codes, so that sufficient cash is available to meet service activity and the Council's Capital Strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

4.1 Current Portfolio Position

The Council's actual and projected debt portfolio is summarised below. The table compares the actual and projected external debt against the Council's estimated borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

£'000 as at 31 March	2017/18 Actual	2018/19 Probable	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Borrowing	81,754	89,146	136,993	166,442	166,069	165,252	164,887
Other Long Term Liabilities	94,789	90,480	85,747	80,960	75,954	70,830	65,548
Total Gross Debt (Prudential Indicator PI-3)	176,543	179,626	222,740	247,402	242,023	236,082	230,435
CFR – the borrowing need	193,235	196,508	216,633	251,566	276,462	276,591	264,732
(Under) / Over Borrowing (Prudential Indicator PI-6)	(16,692)	(16,882)	6,107	(4,164)	(34,439)	(40,509)	(34,297)

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these (PI-3) is that the Council needs to ensure that its gross debt figure (shown above) does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded by external loan debt as the cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy remains both prudent and cost effective as investment returns are low and counterparty risk is relatively high.

4.2 Treasury Indicators: Limits to Borrowing Activity

a) The Operational Boundary (Prudential Indicator PI-4)

This indicator takes account of capital expenditure and financing requirements and projects the expected level of external debt for operational purposes. Temporary breaches of the operational boundary may occur as a result of unexpected cash movements. The Head of Accountancy (Chief Financial Officer) has delegated authority to manage the movement between borrowing and other long term liabilities such as finance leases in accordance with option appraisal and value for money considerations if it is considered appropriate. Any such movement will be reported to Council following the change.

Operational boundary for external debt (PI-4) £'000	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Borrowing	139,146	166,993	166,442	166,069	165,252
Other Long Term Liabilities	90,480	85,747	80,960	75,954	70,830
Total	229,626	252,740	247,402	242,023	236,082

b) The Authorised Limit for External Debt (Prudential indicator PI-5)

This is a key prudential indicator and represents a control on the maximum level of borrowing. It is similar to the operational boundary but includes further headroom to accommodate adverse cash flow movements and opportunities for advance borrowing. It represents a legal limit which external debt is prohibited to exceed and reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. In circumstances where a breach takes place the reasons shall be reported to the next meeting of the Council and the limit revised if appropriate.

This is the statutory limit (Affordable Capital Expenditure Limit) determined under section 35(1) of the Local Government in Scotland Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

The proposed Authorised Limit for the Council is as follows:

Authorised limit for external debt (PI-5) £'000	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Borrowing	160,018	192,042	191,408	190,979	190,040
Other Long Term Liabilities	90,480	85,747	80,960	75,954	70,830
Total	250,498	277,789	272,368	266,933	260,870

c) Leasing – International Financial Reporting Standard (IFRS) 16

From 1 April 2020, leases which were previously off balance sheet will now be included. As leases form part of the other long term liability figures which make up the Prudential Indicators above, it is possible that the Indicators currently suggested will be exceeded. Once the detailed data gathering has been substantially completed, later in the 2020/21 financial year, an updated report may be required to inform the members of the detailed impact of IFRS 16 with amended Prudential Indicators for approval.

4.3 Prospects for Interest Rates

The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. **Annex B** draws together a number of current city forecasts for short term (Base Rate) and longer fixed interest rates and the following table and commentary below gives the central view of Link Asset Services.

Link Asset Services Interest Rate View													
	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%	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	0.90%	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	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	1.20%	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	2.10%	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%	2.60%	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%	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%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

The flow of generally positive economic statistics after the quarter ended 30 June 2018 meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth became increasingly strong during 2018 until slowing significantly during the last quarter. At their November Quarterly Inflation Report meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We, therefore, saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity prices as they sold out of holding riskier assets. However, by early January 2019, US 10 year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession.

Equity prices have been very volatile on alternating good and bad news during this period.

From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

Investment and borrowing rates

- Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.
- Borrowing interest rates have been volatile so far in 2018-19 and while they were on a rising trend during the first half of the year they have backtracked since then until early January. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;
- There will remain a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

Annex C contains a more comprehensive Economic Background narrative from Link Asset Services.

4.4 Borrowing Strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded by external loan debt as the cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy remains both prudent and cost effective as investment returns are low and counterparty risk is still an issue to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Head of Accountancy (Chief Financial Officer) will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *If it was 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 will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.*
- *If it was felt that there was a significant risk of a much sharper **RISE** in long and short term rates than that currently forecast, 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 will be re-appraised. Most likely, fixed funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.*

Any decisions will be reported to Members at the next available opportunity.

4.5 Treasury Management Limits on Activity

There are three debt related treasury activity limits. The purpose of these is to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive, they will impair the opportunities to reduce costs / improve performance. The indicators are:

(i) Upper limits on fixed interest rate exposure (Treasury Indicator TI-1)

This covers a maximum limit for borrowing exposure to fixed interest rates, based on the debt position and is set at 100%.

(ii) Upper limits on variable interest rate exposure (Treasury Indicator TI-2)

This identified a maximum limit for borrowing exposure to variable interest rates based upon the debt position and is set at 30%.

(iii) Maturity structure of borrowing (Treasury Indicator TI-3)

Gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing. The Council has set the limit of debt maturing in any one year to 15% at the time of borrowing.

4.6 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

The Head of Accountancy (Chief Financial Officer) has the authority to borrow in advance of need under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. The Head of Accountancy (Chief Financial Officer) will adopt a cautious approach to any such borrowing and a business case to support the decision making process must consider:

- The benefits of borrowing in advance,
- The risks created by additional levels of borrowing and investment, and
- How far in advance it is reasonable to borrow considering the risks identified

Any such advance borrowing should be reported through the mid-year or annual Treasury Management reporting mechanism.

4.7 Debt Rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will

need to be considered in light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- The generation of cash savings and/or discounted cash flow savings
- Helping to fulfil the treasury strategy
- Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to Council at the earliest meeting following its action.

4.8 Municipal Bond Agency

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority may make use of this new source of borrowing as and when appropriate.

5 Investment Strategy

5.1 Investment Objectives and Policy

The Council's investment policy implements the requirements of the Local Government Investments (Scotland) Regulations 2010 (and accompanying Finance Circular 5/2010) and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the CIPFA TM Code").

The above regulations and guidance place a high priority on the management of risk. The Council's investment priorities will be security first, liquidity second and then return. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "**credit default swaps**" and overlay that information on top of the credit ratings.

3. **Other information sources** used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. This authority has defined the list of **types of investment instruments** that are permitted investments authorised for use in Annex D. Annex E expands on the risks involved in each type of investment and the mitigating controls.

5. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the information gathered (see points 1-3 above)

6. This authority has engaged **external consultants**, (see paragraph 2.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

7. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 5.6c).

8. The Council has determined that it will only use approved counterparties from within the United Kingdom.

9. As a result of the change in accounting standards for 2018/19 under **IFRS 9**, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund.

However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 5.7). Regular monitoring of investment performance will be carried out during the year.

5.2 Creditworthiness Policy

The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security as set out in the investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

The Head of Accountancy (Chief Financial Officer) will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary (see **Annex F**). These criteria provide an overall pool of classes of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied by Link Asset Services our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list, with the exception of the Council's own banker. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applied to a counterparty that is already at the minimum Council criteria will be suspended from use, with all other counterparties being reviewed in light of market conditions.

The criteria for providing a pool of high quality investment counterparties are:

- Banks 1 - good credit quality – the Council will only use UK banks which have, as a minimum, the following Fitch (or equivalent) ratings (where rated):
 - i. Short Term – *F1*
 - ii. Long Term – *A-*
- Banks 2 – Part nationalised UK bank – Royal Bank of Scotland ring-fenced operations*. This bank can be included if it continues to be part nationalised or it meets the ratings in Banks 1 above.
- Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time invested.
- Bank subsidiary and treasury operation - The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- Building societies - The Council will use societies which meet the ratings for banks outlined above;
- Money Market Funds
- Ultra-Short Dated Bond Funds
- UK Government (including gilts and the DMADF)
- Local authorities, including Police & Fire

Use of additional information other than credit ratings. Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

Hub Schemes. The Council also invests in hub projects, which are based on robust business cases and a cashflow from public sector organisations (i.e low risk). As additional assurance we restrict such investments to hub schemes where the Council is a significant participant.

Time and monetary limits applying to investments. The time and monetary limits for institutions on the Council's counterparty list are as stated in **Annex F**.

UK banks – *ring fencing

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

5.3 Country and Council's Banker

a) Country Limits

The Council has determined that it will only use approved counterparties from within the United Kingdom.

b) Council's Own Banker

The Council's own banker (The Clydesdale bank) will be maintained on the Council's counterparty list in situations where rating changes mean this is below the above criteria. This is to allow the Council to continue to operate normal current account banking facilities overnight and short-term investment facilities.

5.4 The Monitoring of Investment Counterparties

All credit ratings will be monitored on a weekly basis. The Council is alerted to changes to ratings of all three agencies through its use of the creditworthiness service of Link Asset Services.

- If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- Additional market information (for example Credit Swaps and negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

If the Council has funds invested in an institution which is downgraded to below the acceptable rating criteria, the Council will enter discussions with the counterparty to establish if the funds can be returned early. This however will be subject to an appropriate cost versus risk assessment of the specific situation.

The criteria for choosing counterparties set out above provide a sound approach to investment in “normal” market circumstances. Under exceptional market conditions, the Head of Accountancy (Chief Financial Officer) may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out in this Strategy. These restrictions will remain in place until the Head of Accountancy (Chief Financial Officer) is of an opinion that the banking system has returned to ‘normal’. Similarly a restriction may be placed on the duration of investments.

5.5 Types of Investments

For institutions on the approved counterparty list, investments will be restricted to safer instruments (as listed in **Annex E**). Currently this involves the use of money market funds, the Debt Management Agency Deposit Facility (DMADF) and institutions with higher credit ratings than the minimum permissible rating outlines in the investment strategy, as well as the Council’s own bank.

Where appropriate, investments will be made through approved brokers. The current list of approved brokers comprises:

- Sterling International Brokers Limited
- Tradition (UK) Limited
- Martins Brokers
- King and Shaxson Capital Limited

5.6 Investment Strategy and bank rate projections

a) In-house funds

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

b) Bank Rate

On the assumption that the UK agree a Brexit deal in Spring 2019, then the Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by Quarter 1 2022. Bank Rate forecasts for financial year-ends (March) as at December 2018 are:

2018/19	0.75%
2019/20	1.25%
2020/21	1.50%
2021/22	2.00%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

	Now
2018/19	0.75%
2019/20	1.00%
2020/21	1.50%
2021/22	1.75%
2022/23	1.75%
2023/24	2.00%
Later Years	2.50%

The overall balance of risk to these forecasts is currently skewed to the upside and are dependent on how strong GDP growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

**c) Investment Treasury Indicator And Limit (Treasury Indicator TI-4)
Total Principal Funds Invested for Greater Than 365 days**

These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The treasury indicator and limit proposed is:

Maximum principal sums invested > 365 days (TI-4)			
	2019/20	2020/21	2021/22
Principal sums invested > 365 days	5%	5%	5%

For positive cash balances and in order to maintain liquidity, the Council will seek to use overnight investment accounts, short term (< 1 month) notice accounts, money market funds and short-dated deposits (overnight to six months).

5.7 Risk Benchmarking

These benchmarks are simple guides to minimise risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmarks is that officers will monitor the current and trend position and amend the operational strategy to manage risk as

conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or annual report.

a) Security

The Council's **maximum** security risk benchmark for the current portfolio, when compared to historic default tables, is:

0.06% historic risk of default when compared to the whole portfolio for 1 year.

b) Liquidity

In respect of this area the Council seeks to maintain:

- Bank Overdraft: £100,000

c) Yield

Local Measures of yield benchmarks are:

Investments – Internal returns above the 7 day LIBID rate

d) Activity

At the end of the financial year, the Head of Accountancy (Chief Financial Officer) will report on its investment activity as part of the annual treasury report.

6 Performance Indicators

6.1 The CIPFA Code requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking.

6.2 Debt Performance Indicators

- (i) 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

- (ii) Average borrowing rate movement year on year

Target is to maintain or reduce the average borrowing rate for the Council versus 2018/19.

6.3 Loan Charges

Loan Charges for 2019/20 are expected to be at or below the Revenue Budget estimate contained in the Council's Financial Plans to be approved in February 2019, which are estimated as follows:

£m	2019/20 Estimate	2020/21 Estimate
Capital Repayments	6.919	6.617
Interest on Borrowing	3.479	4.098
Expenses	0.147	0.150
Total Loan Charges*	10.545	10.865

**The Loan Charges exclude the capital element of PPP repayments*

7 Monitoring and Reporting

In line with the CIPFA Code the following formal reporting arrangements will be adopted:

Requirement	Purpose	Responsible Body	Frequency
Scrutiny of Treasury Management Strategy	Detailed scrutiny prior to annual approval by Council	Audit & Scrutiny Committee	Annually
Treasury Management Strategy	Reporting on Annual Strategy	Council	Annually prior to start of new financial year
Scrutiny of Treasury Management Mid-Year Report	Detailed scrutiny prior to approval by Council	Audit & Scrutiny Committee	Annually in October/November of the current year
Treasury Management Mid-Year Report	Mid-Year Performance Report	Council	Annually after reported to the Audit & Scrutiny Committee
Scrutiny of Treasury Management Annual Report	Detailed scrutiny prior to approval by Council	Audit & Scrutiny Committee	Annually in September/ October of the financial year
Treasury Management Annual Report	Annual Performance report for previous financial year	Council	Annually after reported to the Audit & Scrutiny Committee
Treasury Management Practices		Council	As appropriate
Treasury Management Policy Statement	Reviews and Revisions	Council	As required

8 Member and Officer Training

The increased Member consideration of treasury management matters and the need to ensure that officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. This Council will address this important issue by:

a) Elected Members

- Working with members to identify their training needs
- Working with Link Asset Services to identify appropriate training provision for elected members

- b) Officers dealing with treasury management matters will have the option of various levels of training including:
- Treasury courses run by the Council's advisers
 - Attendance at CIPFA treasury management training events
 - Attendance at the CIPFA Scottish Treasury Management Forum and information exchanged via the Treasury Management Forum network
 - Training identified as part of the Council's Performance Review & Development system in line with the approved Treasury Management Practices (TMPs).

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ANNEXES

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ANNEX A

SUMMARY OF PRUDENTIAL AND TREASURY INDICATORS

Indicator Reference	Indicator	Page Ref.	2019/20	2020/21	2021/22	2022/23	2023/24	
PRUDENTIAL INDICATORS								
Capital Expenditure Indicator								
PI-1	Capital Expenditure Limits		£'000	£'000	£'000	£'000	£'000	
	General Fund		48,017	58,460	52,540	19,586	11,497	
	Housing		10,969	10,320	13,693	12,167	4,874	
	Total		58,986	68,780	66,233	31,753	16,371	
PI-2	Capital Financing Requirement		£'000	£'000	£'000	£'000	£'000	
	General Fund		182,043	212,456	231,813	227,551	215,635	
	Housing		34,590	39,110	44,649	49,040	49,097	
	Total		216,633	251,566	276,462	276,591	264,732	
Affordability Indicator								
External Debt Indicators								
PI-3	Gross Debt Borrowing		£'000	£'000	£'000	£'000	£'000	
	Other Long Term Liabilities		136,993	166,442	166,069	165,252	164,887	
	Total		85,747	80,960	75,954	70,830	65,548	
			222,740	247,402	242,023	236,082	230,435	
PI-4	Operational Boundary for External Debt Borrowing		£'000	£'000	£'000	£'000	£'000	
	Other Long Term Liabilities		139,146	166,993	166,442	166,069	165,252	
	Total		90,480	85,747	80,960	75,954	70,830	
			229,626	252,740	247,402	242,023	236,082	
PI-5	Authorised Limit for External Debt Borrowing		£'000	£'000	£'000	£'000	£'000	
	Other Long Term Liabilities		160,018	192,042	191,408	190,979	190,040	
	Total		90,480	85,747	80,960	75,954	70,830	
			250,498	277,789	272,368	266,933	260,870	
Indicators of Prudence								
PI-6	(Under)/Over Gross Borrowing against the CFR		£'000	£'000	£'000	£'000	£'000	
			6,107	(4,164)	(34,439)	(40,509)	(34,297)	
TREASURY INDICATORS								
TI-1	Upper Limit to Fixed Interest Rates based on Net Debt		100% of debt position					
TI-2	Upper Limit to Variable Interest Rates based on Net Debt		30% of debt position					
TI-3	Maturity Structure of Fixed Interest Rate Borrowing		15% maturing in any one year					
TI-4	Maximum Principal Sum invested greater than 365 days		5%	5%	5%	5%	5%	

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ANNEX B: INTEREST RATE FORECASTS 2019 – 2022

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1 November 2012.

	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%	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	0.90%	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	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	1.20%	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	2.10%	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%	2.60%	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%	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%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%
Bank Rate													
Link Asset Services	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%
Capital Economics	0.75%	1.00%	1.25%	1.50%	1.70%	1.75%	2.00%	2.00%	-	-	-	-	-
5yr PWLB Rate													
Link Asset Services	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%
Capital Economics	2.03%	2.15%	2.40%	2.65%	2.70%	2.75%	2.80%	2.85%	-	-	-	-	-
10yr PWLB Rate													
Link Asset Services	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%
Capital Economics	2.43%	2.55%	2.80%	3.05%	3.05%	3.05%	3.05%	3.05%	-	-	-	-	-
25yr PWLB Rate													
Link Asset Services	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%
Capital Economics	2.96%	3.08%	3.33%	3.58%	3.53%	3.48%	3.43%	3.38%	-	-	-	-	-
50yr PWLB Rate													
Link Asset Services	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%
Capital Economics	2.78%	2.90%	3.15%	3.40%	3.40%	3.40%	3.40%	3.40%	-	-	-	-	-

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ANNEX C

Link Asset Services 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 and the eurozone, 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 an acceleration of wage inflation. The US Fed has therefore increased rates nine times and the Bank of England twice. However, the ECB is unlikely to start raising rates until late in 2019 at the earliest.

KEY RISKS - central bank monetary policy measures

Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as quantitative easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

The key issue now is that period of stimulating economic recovery and warding off the threat of deflation, is coming towards its close. A new period is well advanced in the US, and started more recently in the UK, of 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 a 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. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously. This meant that both asset categories were exposed to the risk of a sharp downward correction and we have indeed seen a sharp fall in equity values in the last quarter of 2018. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery, by taking too rapid and too strong action, or, conversely, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.** At the time of writing, (early January 2019), financial markets are very concerned that the Fed is being too aggressive with its policy for raising interest rates and is likely to cause a recession in the US economy.

The world economy also needs to adjust to a sharp change in **liquidity creation** over the last five years where the US has moved from boosting liquidity by QE purchases, to reducing its holdings of debt, (currently about \$50bn per month). In addition, the European Central Bank ended its QE purchases in December 2018.

UK. The flow of positive economic statistics since the end of the first quarter of 2018 has shown that pessimism was overdone about the poor growth in quarter 1 when adverse

weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in quarter 2 and by a strong performance in quarter 3 of +0.6%. However, growth in quarter 4 is expected to weaken significantly.

At their November quarterly Inflation Report meeting, the MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary or contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years time, but declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also raise Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor could potentially provide fiscal stimulus to support economic growth, though at the cost of increasing the budget deficit above currently projected levels.

It is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel will take well into spring 2019. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019, (on the assumption that a Brexit deal is agreed by both the UK and the EU). The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.

Inflation. The Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.1% in December. In the November Bank of England quarterly Inflation Report, inflation was forecast to still be marginally above its 2% inflation target two years ahead, (at about 2.1%), given a scenario of minimal increases in Bank Rate.

As for the **labour market** figures in October, unemployment at 4.1% was marginally above a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high, 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 3.3%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates less CPI inflation), earnings are currently growing by about 1.2%, the highest level since 2009. This 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 was 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.

In the **political arena**, the Brexit deal put forward by the Conservative Minority Government was defeated on 15 January. It is unclear, at the time of writing, how this situation will move forward. However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to reaching an orderly Brexit though the risks are increasing that it may not be possible to get full agreement by the UK and EU before 29 March 2019, in which this withdrawal date is likely to be pushed back to a new date. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

USA. President Trump's massive easing of fiscal policy is fuelling a, (temporary), boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. The strong growth in employment numbers and the reduction in the unemployment rate to 3.9% near to a recent 49 year low, has fed through to an upturn in wage inflation which hit 3.2% in November. However, CPI inflation overall fell to 2.2% in November and looks to be on a falling trend to drop below the Fed's target of 2% during 2019. The Fed has continued on its series of increases in interest rates with another 0.25% increase in December to between 2.25% and 2.50%, this being the fifth increase in 2018 and the ninth in this cycle. However, they did also reduce their forecast for further increases from three to two. This latest increase compounded investor fears that the Fed is over doing the speed and level of increases in rates and that is going to cause a US recession as a result. There is also much evidence in previous monetary policy cycles of the Fed's series of increases doing exactly that. Consequently, we have seen stock markets around the world falling under the weight of fears around the Fed's actions, the trade war between the US and China and an expectation that world growth will slow.

The tariff war between the US and China has been generating a lot of heat during 2018, but it is not expected that the current level of actual action would have much in the way of a significant effect on US or world growth. However, there is a risk of escalation if an agreement is not reached soon between the US and China. The results of the mid-term elections are not expected to have a material effect on the economy.

Eurozone. Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this was probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of its manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of nearly 2% for 2018, the horizon is less clear than it seemed just a short while ago. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank ended all further purchases in December 2018. The ECB is forecasting inflation to be a little below its 2% top limit through the next three years so it may find it difficult to warrant a start on raising rates by the end of 2019 if the growth rate of the EU economy is on a weakening trend.

China. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. 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.

Emerging countries. Argentina and Turkey are currently experiencing major headwinds and are facing challenges in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy, (around 1% each), so the fallout from the expected recessions in these countries will be minimal.

INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 4.3 are **predicated on an assumption of an agreement being reached on Brexit between the UK and the EU**. On this basis, while GDP growth is likely to be subdued in 2019 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement is likely to lead to a boost to the rate of growth in 2020 which could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

- In the event of an **orderly non-agreement exit**, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall.
- If there was a **disorderly Brexit**, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

However, there would appear to be a majority consensus in the Commons against any form of non-agreement exit so the chance of this occurring has now substantially diminished.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for ten years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England monetary policy** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **eurozone sovereign debt crisis**, possibly in **Italy**, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. The EU rejected the initial proposed Italian budget and demanded cuts in government spending which the Italian government initially refused. However, a fudge was subsequently agreed but only by delaying the planned increases in expenditure to a later year. This has therefore only been kicked down the road to a later time. The rating agencies have started on downgrading Italian debt to one notch above junk level. If Italian debt were to fall below

investment grade, many investors would be unable to hold it. Unsurprisingly, investors are becoming increasingly concerned by the words and actions of the Italian government and consequently, Italian bond yields have risen at a time when the government faces having to refinance large amounts of debt maturing in 2019.

- Weak capitalisation of some **European banks**. Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian government debt - debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.
- **German minority government**. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD is reviewing whether it can continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018, (a new party leader has now been elected). However, this makes little practical difference as she is still expected to aim to continue for now as the Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.
- **Other minority eurozone governments**. Spain, Portugal, Ireland, the Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile. Sweden is also struggling to form a government due to the anti-immigration party holding the balance of power, and which no other party is willing to form a coalition with. The Belgian coalition collapsed in December 2018 but a minority caretaker government has been appointed until the May EU wide general elections.
- **Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU while **Italy**, this year, has also elected a strongly anti-immigration government. Elections to the EU parliament are due in May/June 2019.
- Further increases in interest rates in the US could spark a **sudden flight of investment funds** from more risky assets e.g. shares, into bonds yielding a much improved yield. Throughout the last quarter of 2018, we saw a sharp fall in equity markets but this has been limited, as yet. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.
- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks**, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- **Brexit** – if both sides were to agree by 29 March a compromise that quickly removed all threats of economic and political disruption and so led to an early boost to UK economic growth.

- **The Fed causing a sudden shock in financial markets** through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

Brexit timetable and process

- March 2017: UK government notified the European Council of its intention to leave under the Treaty on European Union Article 50 on 29 March 2019.
 - 25.11.18 EU27 leaders endorsed the withdrawal agreement
 - Dec 2018 vote in UK Parliament on the agreement postponed
 - 21.12.18 – 8.1.19 UK Parliamentary recess
 - 15.1.19 Brexit deal defeated in Commons by a large margin
 - Up to 29.3.19 second vote (?) in UK parliament
 - By 29.3.19 if the UK Parliament approves a deal, then ratification by EU Parliament requires a simple majority
 - By 29.3.19 if UK and EU parliaments agree the deal, EU Council needs to approve the deal; 20 countries representing 65% of the EU population must agree
 - 29.3.19 Either the UK leaves the EU or asks the EU for agreement to an extension of the Article 50 period if UK Parliament has been unable to agree on a Brexit deal
-
- 29.3.19: if an agreement is reached with the EU on the terms of Brexit, then this will be followed by a proposed **transitional period ending around December 2020**.
 - UK continues as a full EU member until March 2019 with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy may leave the single market and tariff free trade at different times during the transitional period.
 - The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
 - The UK would aim for a negotiated agreed withdrawal from the EU, although the UK could also exit without any such agreements in the event of a breakdown of negotiations.
 - If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
 - On full exit from the EU: the UK parliament would repeal the 1972 European Communities Act.

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ANNEX D

Objectives of each type of Permitted Investment instrument

1. DEPOSITS

The following forms of 'investments' are actually more accurately called deposits as cash is deposited in an account until an agreed maturity date or is held at call.

- a) **Debt Management Agency Deposit Facility.** This offers the lowest risk form of investment available to local authorities as it is effectively an investment placed with the Government. It is also easy to use as it is a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts. As it is low risk it also earns low rates of interest. However, it is very useful for authorities whose overriding priority is the avoidance of risk. The longest period for a term deposit with the DMADF is 6 months.
- b) **Term deposits with high credit worthiness banks and building societies.** This is the most widely used form of investing used by local authorities. It offers a much higher rate of return than the DMADF (dependent on term). The authority will ensure diversification of its portfolio of deposits ensuring that an approved maximum can be placed with any one institution or group. In addition, longer term deposits offer an opportunity to increase investment returns by locking in high rates ahead of an expected fall in the level of interest rates. At other times, longer term rates can offer good value when the markets incorrectly assess the speed and timing of interest rate increases. This form of investing therefore, offers a lot of flexibility and higher earnings than the DMADF. Where it is restricted is that once a longer term investment is made, that cash is locked in until the maturity date.
- c) **Call accounts with high credit worthiness banks and building societies.** The objectives are as for 1b. but there is instant access to recalling cash deposited. This generally means accepting a lower rate of interest than that which could be earned from the same institution by making a term deposit. Some use of call accounts is highly desirable to ensure that the authority has ready access to cash when needed to pay bills.

2. DEPOSITS WITH COUNTERPARTIES CURRENTLY IN RECEIPT OF GOVERNMENT SUPPORT / OWNERSHIP

These banks offer another dimension of creditworthiness in terms of Government backing through either partial or full direct ownership. The view of this authority is that such backing makes these banks attractive institutions with whom to place deposits, and that will remain our view if the UK sovereign rating were to be downgraded in the coming year.

- a) **Term deposits with high credit worthiness banks which are fully or semi nationalised.** As for 1b. but Government full, (or substantial partial), ownership, implies that the Government stands behind this bank and will be deeply committed to providing whatever support that may be required to ensure the continuity of that bank. This authority considers that this indicates a low and acceptable level of residual risk.

3. COLLECTIVE INVESTMENT SCHEMES STRUCTURED AS OPEN ENDED INVESTMENT COMPANIES (OEICS)

- a) **Government liquidity funds.** These are the same as money market funds (see below) but only invest in government debt issuance with highly rated governments. Due to the higher quality of underlying investments, they offer a lower rate of return than MMFs. However, their net return is typically on a par with the DMADF, but with instant access.
- b) **Money Market Funds (MMFs).** By definition, MMFs are AAA rated and are widely diversified, using many forms of money market securities including types which this authority does not currently have the expertise or capabilities to hold directly. However, due to the high level of expertise of the fund managers and the huge amounts of money invested in MMFs, and the fact that the weighted average maturity (WAM) cannot exceed 60 days, MMFs offer a combination of high security, instant access to funds, high diversification and good rates of return compared to equivalent instant access facilities. They are particularly advantageous in falling interest rate environments as their 60 day WAM means they have locked in investments earning higher rates of interest than are currently available in the market. MMFs also help an authority to diversify its own portfolio as e.g. a £2m investment placed directly with HSBC is a 100% risk exposure to HSBC whereas £2m invested in a MMF may end up with say £10,000 being invested with HSBC through the MMF. For authorities particularly concerned with risk exposure to banks, MMFs offer an effective way of minimising risk exposure while still getting much better rates of return than available through the DMADF.
- c) **Ultra-short dated bond funds.** These funds are similar to MMFs, can still be AAA rated but have variable net asset values (VNAV) as opposed to a traditional MMF which has a Constant Net Asset Value (CNAV). They aim to achieve a higher yield and to do this either take more credit risk or invest out for longer periods of time, which means they are more volatile. These funds can have WAM's and Weighted Average Life (WAL's) of 90 – 365 days or even longer. Their primary objective is yield and capital preservation is second. They therefore are a higher risk than MMFs and correspondingly have the potential to earn higher returns than MMFs.

4. SECURITIES ISSUED OR GUARANTEED BY GOVERNMENTS

The following types of investments are where an authority directly purchases a particular investment instrument, a security, i.e. it has a market price when purchased and that value can change during the period the instrument is held until it matures or is sold. The annual earnings on a security is called a yield i.e. it is normally the interest paid by the issuer divided by the price you paid to purchase the security unless a security is initially issued at a discount e.g. treasury bills.

- a) **Treasury bills.** These are short term bills (up to 12 months, although none have ever been issued for this maturity) issued by the Government and so are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales could incur a net cost during the period of ownership.

- b) **Gilts.** These are longer term debt issuance by the UK Government and are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales may incur a net cost. Market movements that occur between purchase and sale may also have an adverse impact on proceeds. The advantage over Treasury bills is that they generally offer higher yields the longer it is to maturity (for most periods) if the yield curve is positive.

5. SECURITIES ISSUED BY CORPORATE ORGANISATIONS

The following types of investments are where an authority directly purchases a particular investment instrument, a security, i.e. it has a market price when purchased and that value can change during the period the instrument is held until it is sold. The annual earnings on a security is called a yield i.e. is the interest paid by the issuer divided by the price you paid to purchase the security. These are similar to the previous category but corporate organisations can have a wide variety of credit worthiness so it is essential for local authorities to only select the organisations with the highest levels of credit worthiness. Corporate securities are generally a higher risk than government debt issuance and so earn higher yields.

- a) **Certificates of deposit (CDs).** These are shorter term securities issued by deposit taking institutions (mainly financial institutions). They are negotiable instruments, so can be sold ahead of maturity and also purchased after they have been issued. However, that liquidity can come at a price, where the yield could be marginally less than placing a deposit with the same bank as the issuing bank.
- b) **Corporate bonds.** These are (long term) bonds (usually bearing a fixed rate of interest) issued by a financial institution, company or other non-government issuer in order to raise capital for the institution as an alternative to issuing shares or borrowing from banks. They are generally seen to be of a lower creditworthiness than government issued debt and so usually offer higher rates of yield.
- c) **Floating rate notes.** These are bonds on which the rate of interest is established periodically with reference to short-term interest rates.

6. OTHER

- a. **Investment Properties fund.** This is a collective investment fund specialising in property. Rather than owning a single property with all the risk exposure that means to one property in one location rising or falling in value, maintenance costs, tenants actually paying their rent / lease etc, a collective fund offers the advantage of diversified investment over a wide portfolio of different properties. This can be attractive for authorities who want exposure to the potential for the property sector to rise in value. However, timing is critical to entering or leaving this sector at the optimum times of the property cycle of rising and falling values. Typically, the minimum investment time horizon for considering such funds is at least 3-5 years.
- b. **Loans to 3rd parties.** These are loans provided to third parties at either market rates of interest or below market rates. Each application is supported by the service rationale

behind the loan and requires member approval. These loans are highly illiquid and may exhibit credit risk.

- c. **Loans to a Local Authority Company/ Partnership or Charity.** These loans have to be supported by the service rationale /business case and requires member approval. In general these loans will involve some form of security or clear cash flow that is available to service the debt. These loans are highly illiquid and may exhibit credit risk.
- d. **Shares in Hub schemes.** These are shares in projects that have both Council and the Scottish Government as participants. As such the Council are well placed to influence and ensure the successful completion of the projects, which are based on robust business cases with a cash flow from the public sector organisations. These investments are highly illiquid with a low credit risk.

ANNEX E

Credit and Counterparty Risk Management

Permitted Investments, Associated Controls and Limits for East Renfrewshire Council and East Renfrewshire Culture & Leisure Trust

Type of Investment	Treasury Risks	Mitigating Controls	Limits
a. Deposits with the Debt Management Account Facility (UK Government) (Very low risk)	This is a deposit with the UK Government and, as such, counterparty and liquidity risk is very low, and there is no risk to value. Deposits can be between overnight and 6 months	Little mitigating controls required. As this is a UK Government investment, the monetary limit is £5,000,000	£5m, maximum 6 months.
b. Deposits with other local authorities or public bodies (Very low risk)	These are considered quasi UK Government debt and, as such counterparty risk is very low, and there is no risk to value. Liquidity may present a problem as deposits can only be broken with the agreement of the counterparty, and penalties can apply.	Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment.	£5m (per body), maximum 6 months
c. Money Market Funds (MMFs) Low Volatility Net Asset Value (LVNAV) or Variable Net Asset Value (VNAV) (Very low risk)	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the MMFs has a “AAA” rated status from either Fitch, Moody’s or Standard & Pools.	£5m per fund/£35m overall
d. Ultra-Short Dated Bond Funds (Low risk)	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where they have a “AAA” rated status from either Fitch, Moody’s or Standard and Poor’s.	£10m overall, part of category c.

<p>e. Call account deposit accounts with financial institutions (banks and building societies) (Low risk depending on credit rating)</p>	<p>These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. These type of investments have no risk to value, liquidity is high and investment can be returned at short notice</p>	<p>The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. Day to day investment dealing with the criteria will be further strengthened by use of additional market intelligence.</p>	<p>As shown in the counterparty listing (Annex F)</p>
<p>f. Term deposits with financial institutions (banks and building societies) (Low to medium risk depending on period & credit rating)</p>	<p>These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is low and term deposits can only be broken with the agreement of the counterparty, and penalties may apply.</p>	<p>The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Pooors. Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.</p>	<p>As shown in the counterparty listing (Annex F)</p>
<p>g. UK Government Gilts and Treasury Bills (Very low risk)</p>	<p>These are marketable securities issued by the UK Government and, as such, counterparty and liquidity risk is very low, although there is potential risk to value arising from an adverse movement in interest rates (no loss if these are held to maturity).</p>	<p>Little counterparty mitigating controls are required, as this is a UK Government investment. The potential for capital loss will be reduced by limiting the maximum monetary and time exposures.</p>	<p>£5m, maximum 6 months</p>
<p>h. Certificates of Deposit with Financial Institutions (Banks & Building Societies) (Low risk)</p>	<p>These are short dated marketable securities issued by financial institutions and as such counterparty risk is low, but will exhibit higher risks than categories (a), (b) and (c) above. There is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates (no loss if these are held to maturity). Liquidity risk will normally be low.</p>	<p>The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.</p>	<p>Dependent on institution as listed in counterparty listing in annex F</p>

<p>i. Corporate Bonds (Medium to high risk depending on period and credit rating)</p>	<p>These are marketable securities issued by financial and corporate institutions. Counterparty risk will vary and there is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates. Liquidity risk will be low.</p>	<p>The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. Fixed bonds will be restricted to those meeting the base criteria. Corporate Bonds will be restricted to those meeting the base criteria.</p> <p>Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.</p>	<p>Dependent on institution as listed in counterparty listing in annex F</p>
<p>j. Floating Rate Note (Medium to high risk depending on period and credit rating)</p>	<p>This is a money market instrument with a floating /variable rate of interest, which re-fixes over a reference rate, for example LIBOR.</p>	<p>The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. The Floating Rate Note will be restricted to those meeting the base criteria. Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.</p>	<p>Dependent on institution as listed in counterparty listing in annex F</p>
<p>k. Investment properties (Medium Risk)</p>	<p>These are non-service properties which are being held pending disposal or for a longer-term rental income stream. These are highly illiquid assets with high risk to value (the potential for property prices to fall or for rental voids)</p>	<p>In larger investment portfolios, some small allocation of property based investment may counterbalance/compliment the wider cash portfolio. Property holding will be re-valued regularly and reported annually with gross and net rental streams.</p>	<p>No limit</p>
<p>l. Loans to third parties, including soft loans (Low to Medium Risk depending on Credit Risk)</p>	<p>These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.</p>	<p>Each third party loan requires Member approval and each application is supported by the service rationale behind the loan and the likelihood of partial or full default.</p>	<p>£0.5m</p>

<p>m. Loans to a local authority company/ partnership or charity</p> <p>(Low Risk)</p>	<p>These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid</p>	<p>Each loan to a local authority company/LLP requires Member approval and each application is supported by the service rationale/business case behind the loan and the likelihood of partial or full default. In general these loans will involve some form of security or clear cash flow that is available to service the debt.</p>	<p>£1m</p>
<p>n. Shares in Hub Schemes</p> <p>(Very Low Risk)</p>	<p>These are investments that are exposed to the success or failure of individual projects and are highly illiquid.</p>	<p>The Council and Scottish Government (via the SFT) are participants in and party to the governance and controls within the project structure. As such they are well placed to influence and ensure the successful completion of the project's term.</p> <p>These projects are based on robust business cases with a cash flow from public sector organisations (i.e. low credit risk)</p>	<p>Investment limited to HUB schemes where the Council is a major participant</p>

The Monitoring of Investment Counterparties

The status of counterparties will be monitored regularly. The Council receives credit rating and market information from Link Asset Services, including when ratings change, and counterparties are checked promptly. On occasion rating may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately (with the exception of the Council's Bank) and if required new counterparties which meet the criteria will be added to the list with written permission of the Head of Accountancy (Chief Financial Officer).

Annex F

EAST RENFREWSHIRE COUNCIL

ORGANISATIONS APPROVED FOR THE INVESTMENT OF SURPLUS FUNDS

Banking Group	Individual Counterparty	Limits Deposit	Transaction
Bank of England	Debt Management Office	£5m	£5m
	UK Treasury Bills	£5m	£5m
Barclays Banking Group	Barclays Bank	£5m	£5m
Goldman Sachs International Bank		£5m	£5m
Lloyds Banking Group:	Bank of Scotland	} £10m	£10m
	Lloyds Bank		
Royal Bank of Scotland Group:	Royal Bank of Scotland	} £5m	£5m
	National Westminster Bank		
Santander Group	Santander UK PLC	£5m	£5m
Standard Chartered Bank		£5m	£5m
Clydesdale Bank		£0	£0
Building Societies			
Nationwide		£5m	£5m
Local Authorities			
All Local Authorities including Police & Fire		£5m	£5m
Money Market Funds and Ultra-Short Dated Bond Funds			
Maximum limit of £5m per fund, exception being Federated with a maximum of £10m		£35m	£5m

Credit Ratings

	Fitch		Moody's		S&P	
	LT	ST	LT	ST	LT	ST
Minimum Criteria	A-	F1	A3	P-1/P-2	A	A-1/A-2

(Unless Government backed)

(please note credit ratings are not the sole method of selecting counterparty)

Limit

Investment of surplus funds is permitted in each of the above organisations, with the limits set on an individual basis by the Head of Accountancy (Chief Financial Officer).

The limit may only be exceeded or another organisation approved with the written permission of the Head of Accountancy (Chief Financial Officer).

Deposit Periods

The maximum period for any deposit is currently set at 6 months, based on the Link Assets Services suggested Duration Matrix, with the exception of the Bank of Scotland which is set at 365 days. These limits can only be exceeded with the written permission of the Head of Accountancy (Chief Financial Officer).

Hub scheme deposit periods are dependent on the lifetime of the associated scheme.

GLOSSARY OF TERMS

CIPFA	Chartered Institute of Public Finance and Accountancy
CIPFA Code	Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes
CFR	Capital Financing Requirement is the estimated level of borrowing or financing needed to fund capital expenditure.
Consent to Borrow	Para 1 (1) of Schedule 3 of the Local Government (Scotland) Act 1975 (the 1975 Act) effectively restricts local authorities to borrowing only for capital expenditure. Under the legislation Scottish Ministers may provide consent for local authorities to borrow for expenditure not covered by this paragraph, where they are satisfied that the expenditure should be met by borrowing.
Gilts	A gilt is a UK Government liability in sterling, issued by HM Treasury and listed on the London Stock Exchange. The term “gilt” or “gilt-edged security” is a reference to the primary characteristic of gilts as an investment: their security. This is a reflection of the fact that the British Government has never failed to make interest or principal payments on gilts as they fall due.
LIBID	London Interbank Bid Rate The rate at which banks bid on Eurocurrency Deposits, being the rate at which a bank is willing to borrow from other banks.
MPC	Monetary Policy Committee
NHT	National Housing Trust initiative undertaken in partnership with the Scottish Futures Trust.
Other Long Term Liabilities	Balance sheet items such as Public Private Partnership (PPP), and leasing arrangements which already include borrowing instruments.
PPP	Public-Private Partnership.
Prudential Indicators	The Prudential Code sets out a basket of indicators (the Prudential Indicators) that must be prepared and used in order to demonstrate that local authorities have fulfilled the objectives of the Prudential Code.
QE	Quantitative Easing
Treasury Indicators	These consist of a number of Treasury Management Indicators that local authorities are expected to ‘have regard’ to, to demonstrate compliance with the Treasury Management Code of Practice.

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EAST RENFREWSHIRE COUNCIL
AUDIT AND SCRUTINY COMMITTEE

21 February 2019

Report by Clerk

LOCAL EXTERNAL AUDIT REPORT ON HOUSING BENEFIT PERFORMANCE AUDIT RISK ASSESSMENT; AND NATIONAL EXTERNAL AUDIT REPORT ON HOUSING BENEFIT PERFORMANCE AUDIT ANNUAL UPDATE 2017/18

PURPOSE OF REPORT

1. To resubmit information on the local External Audit report on the *Housing Benefit Performance Audit Risk Assessment*, and the national External Audit report on the *Housing Benefit Performance Audit Annual Update 2017/18* for discussion with the Head of Communities, Revenues and Change.

RECOMMENDATION

2. It is recommended that the Committee considers the report and discusses related issues with the Head of Communities, Revenues and Change.

BACKGROUND

3. Copies of the following External Audit reports, published in November 2018, have already been circulated to all Audit and Scrutiny Committee Members:-

- Local External Audit report on the *Housing Benefit Performance Audit Risk Assessment*, and
- National External Audit report on the *Housing Benefit Performance Audit Annual Update 2017/18*.

4. Under the Committee's specialisation arrangements, the Members leading the review of these particular reports are Councillor McLean and Councillor Swift. The Head of Communities, Revenues and Change (previously the Head of Business Change and Revenues) provided comments on these reports, a copy of which is attached and was submitted to the Committee on 24 January. As there was a link between the local and national external audit reports, comments were provided on both in a single report. A copy of the local External Audit report is also amongst papers attached to this report.

5. At the meeting of the Committee that took place on 24 January 2019, following discussion, it was agreed that the Head of Communities, Revenues and Change attend the next meeting to provide an update on progress made addressing issues; and to allow related matters to be discussed with her. The report is resubmitted for that purpose.

RECOMMENDATION

6. It is recommended that the Committee considers the report and discusses related issues with the Head of Communities, Revenues and Change.

Local Government Access to Information Act 1985

Report Author: Linda Hutchison, Clerk to the Committee (Tel.No.0141 577 8388)

e-mail: linda.hutchison@eastrenfrewshire.gov.uk

Background Papers:-

1. Local External Audit report on *Housing Benefit Performance Audit Risk Assessment*;
2. National External Audit report on *Housing Benefit Performance Audit Annual Update 2017/18*; and
3. Related report submitted to the meeting of the Audit and Scrutiny Committee on 24 January 2019.

External Audit Reports – Housing Benefits

Comments for Audit & Scrutiny Committee on 24 January 2019

Prepared by Head of Business Change Services & Revenues

January 2019

INTRODUCTION

1. This paper aims to provide high level comments on the Council's position regarding two External Audit reports on the topic of Housing Benefits. The first is the annual national update by Audit Scotland (*Housing Benefit Performance Audit Annual Update 2017/18*) (circulated previously by the Committee Clerk) and the second is a local report, produced every 2 years (*East Renfrewshire Council Audit of Housing Benefit Risk Assessment Report, November 2018*) (see Annex 1).

BACKGROUND

2. As one of the smallest Housing Benefit services in Scotland, with an annual caseload of around 3,600, we have been planning for the gradual phasing out of Housing Benefit (HB) as a result of the implementation of Universal Credit. There is an eventual national goal to retain only those of pension age and a few complex or specific cases on HB post Universal Credit (UC). National delays in UC implementation have made the planning of resources in recent years a particular challenge.

3. Each year Audit Scotland produces a national update on its Housing Benefit Performance Audit. To produce this overview, Audit Scotland undertakes a Housing Benefit risk assessment in each council every two years. There is a follow-up on the resulting individual council action plans in the interim year.

4. East Renfrewshire Council participated in a Housing Benefit risk assessment in summer 2018, having previously been covered in 2016 – the results were reported to Audit and Scrutiny Committee in November 2016.

5. The purpose of today's paper is to provide the Audit and Scrutiny Committee with comments on this year's national annual report and, to update the Committee on the findings from our own Audit of Housing Benefit in East Renfrewshire Council, carried out in summer 2018 with a report produced by Audit Scotland in November 2018, which is appended as Annex 1. Our resulting action plan is included as Annex 2.

COMMENTS

Housing Benefit Performance Audit Annual Update 2017/18

6. Audit Scotland's Annual Update report provides a useful broader context for our own local report. In a letter to Chief Executives accompanying the report the Chair of the Accounts Commission noted "the report highlights the roll-out of Universal Credit Full Service continues across Scotland and is having an impact on council benefit services. Councils are significantly restructuring benefit services, and the reducing housing benefit caseload and budget pressures are leading to less full-time benefit service employees".

7. The Annual Update states that reports were issued to 5 councils in 2017/18 (not including East Renfrewshire, which was covered in 2018/19). In all 5 councils visited the Accounts Commission concluded that resources available may “not be sufficient to maintain or improve on previous claims processing performance levels”. For these councils a total of 24 risks to continuous improvement were identified. East Renfrewshire will feature in next year’s 2018/19 report.

8. This is a complex area with lot developments which must be planned for and resourced in parallel with maintaining current service provision. Audit Scotland make reference in their report to the ongoing implications of the national roll-out of Universal Credit (UC); the development of the Scottish Social Security Agency and the introduction of two new tools to improve processing performance and debt recovery – the Verify Earning and Pensions (VEP) service which uses real-time information from HMRC and the Debt Service which allows councils to match Housing Benefit debtors to employment and pension data from HMRC – we make good use of these in East Renfrewshire. All of these issues are addressed in a more specific way in the local report we received in November.

9. In recent years our local focus has been on planning for the shift from HB to UC for the majority of cases below pension-age. For Revenues, this meant restructuring and consolidating benefits services; delivering savings predicated on a forecasted declining HB caseload and developing our staff for the future, including multiskilling to build the resilience of what is a small team. More broadly, across the Council, the focus has been on planning for the wide-ranging impact of UC full service roll-out in East Renfrewshire the latest tranche of which took place in September 2018. Elected members were updated on this in a report to Cabinet in June 2018, with a further update in December.

East Renfrewshire Council – Audit of Housing Benefit Risk Assessment Report

10. Over summer 2018, Audit Scotland conducted the above risk assessment of the Housing Benefit (HB) service, with a report published in November 2018 and a resulting action plan submitted to Audit Scotland in December 2018. The risk assessment considers the effectiveness of the benefit service in meeting national and local priorities, business planning and reporting and delivering outcomes.

11. The report itself is a detailed analysis of the specific issues and we have not sought to replicate that here in these comments, rather a summary of the current position and key issues is given to assure the Audit and Scrutiny Committee of our ongoing drive to understand and improve performance against a complex background of nationally driven changes to the benefits system and budget and resource constraints.

12. The report notes the significant structural changes made within the Revenues service, to merge functions and multi-skill our teams to deliver across the range of benefits tasks for business resilience and budgetary purposes. A single team is now responsible for HB, Council Tax Reduction (CTR), Scottish Welfare Fund (SWF) applications and discretionary housing payments (DHP).

13. The report acknowledges that “the council has remained proactive and committed in its efforts to improve service delivery” (p5) and notes the work undertaken to improve overpayment recovery processes and investigate claims processing performance. We acknowledge that performance is mixed, however the report states that since the last audit 2 years ago, “the council has been very proactive in its efforts to improve performance levels and has worked internally, and with key partners, to introduce a number of new initiatives and changes to processes and procedures”.

14. It is also noted that the Council makes good use of the national verification and information-sharing frameworks available to support the identification of potential fraud and automate change event notifications (including several DWP systems and Audit Scotland's National Fraud Initiative).

15. Given the relatively small team working in this area, the report acknowledges the resourcing challenges we have had with loss of experienced staff, vacancies, performance issues and sickness absence. Whilst these issues impacted performance, particularly in 2016/17, there was some improvement in 2017/18, particularly in dealing with changes of circumstances and performance remains above the Scottish average in that area. The report notes the effective use of temporary staff to boost processing resource in the light of national delays to UC. There have also been continued improvements into 2018/19 in accuracy rates, HB overpayment recovery and the level of overpayments which were due to council error.

16. The Audit Scotland report concludes that there are 5 areas that the Council should address and a further 3 that need further work from the last assessment. These include:

- speed of processing for new claims and changes of circumstance, which had seen a decline at the time of the audit
- resourcing challenges to ensure service is set up to deliver
- issues of accuracy of dates recorded in the system
- methodologies for sampling to ensure balance and checking accuracy
- further improving debt recovery
- utilisation of Direct Earnings Attachments (DEA) as a means of recovering overpaid HB.

17. With new management in place in the Revenues Service since August 2018, following several key retirements, there has been a period of consolidation and getting to know the services, resources and budgets and building priorities for action through a new Service Business Plan. Whilst planning for the onward reduction in HB caseload due to UC full service, we remain committed to improving overall performance in the benefits service. We have an action plan in place which addresses the points above (see Annex 2) and are taking a targeted approach towards better use of data, particularly around processing and error rates to help us drive improvement. We will use this information to plan resourcing, to target specific team development and to prioritise workload.

18. The issues of accuracy of reporting have been addressed and we have seen a good improvement in performance in the year to date figures for 2018/19. Previous issues with a drop in accuracy rates were primarily a result of a proactive approach to dealing with a performance issue in the service, which targeted the greatest number of checks on areas with the most likely mistakes. Because of this intended bias, the check, although very important in its own right, was not an objective measure of pre-payment accuracy. Whilst negatively impacting the performance indicator for a particular period, it did help service management to resolve a performance issue in the team which was to the longer-term benefit of the service. An improved accuracy checking regime is in place and this will continue to be reviewed as a priority area. Refresher training was provided for employees in July 2018, with further follow-up sessions planned for next year.

19. As previously stated, resourcing has been an issue for us and this area is now under consideration, with some temporary resources in place and outline budget savings deferred. We have had issues of turnover; absence; and bedding in of a new structure and roles. As acknowledged by Audit Scotland "benefit services across the country have been planning for caseload reductions in conjunction with year on year reductions in funding from the DWP and wider pressures on council budgets" – East Renfrewshire is no different. Our focus has been on preparing for UC and a gradual winding down of HB. National delays in roll-out have

made this a challenge especially against a background of already declining resources and budgets. In the meantime, as we await the full impact of the long-forecasted phasing out of HB, our focus is towards better use of data to inform delivery, planning and improvement and we have begun to see some improvement in the most recent months. This will include considering the balance of processing times against targeted intervention work.

20. We will also further develop our approach to debt recovery, following some targeted work in 2017/18, which improved the 2016/17 performance by 14% and we have seen a further 11% improvement in the year to date figures for 2018/19. This has included signing up to the DWP's HB Debt Service project which lets us send a number of dormant HB overpayments per month to the DWP to match with real-time HMRC employment and pension data. A further area will include a review of our Debt Recovery Policy, with specific consideration of use of Direct Earnings Attachments (DEA) and targeted approaches towards aged debt.

CONCLUSIONS

21. Benefits is a complex and frequently-changing area, with a nationally driven landscape and a range of different agencies involved. National delays in UC implementation have meant maintenance of HB caseloads for far longer than predicted. Against a background of reducing DWP funding and wider pressures on council budgets this has been a challenging time for service delivery and Audit Scotland's annual report highlights that this is the picture across the country. In addition, the DWP have found it difficult to give projections on likely UC caseload with initial projections for the first quarter outstripped within the first month of the recent roll-out in September. This has given us issues in terms of resource planning, particularly in such a small team, and we have had to manage the consequences using the Council's welfare contingency funding.

22. Against this backdrop, we have undertaken a number of initiatives in East Renfrewshire Council to understand and improve benefits processing, which we acknowledge is a mixed picture of performance. Our proactive approach is acknowledged in Audit Scotland's biennial report. We have a firm action plan in place and are committed to continuous improvement and high degrees of accuracy.

Comments from:-

Louise Pringle, Head of Communities, Revenues & Change, January 2019

BACKGROUND REPORTS

- Welfare Contingency Fund - Citizens Advice Bureau: Helping East Renfrewshire Online (HERO) Project, Cabinet 29 November 2018
- Universal Credit Implementation, Cabinet 21 June 2018
- National External Audit Report – Housing Benefit Performance & Audit Annual Update 2016/17, Audit & Scrutiny Committee, 9 November 2017
- National & Local External Audit Reports – Benefits Performance Audit Annual Update 2015/16 and Audit of Housing Benefit and Associated Risk Assessment Report, Audit & Scrutiny Committee 10 November 2016
- National External Audit Reports – Benefits Performance Audit Annual Update 2014/15 and Review of Activity to Reduce Fraud and Error in Housing Benefit, Audit & Scrutiny Committee 21 January 2016

East Renfrewshire Council

Audit of housing benefit Risk assessment report

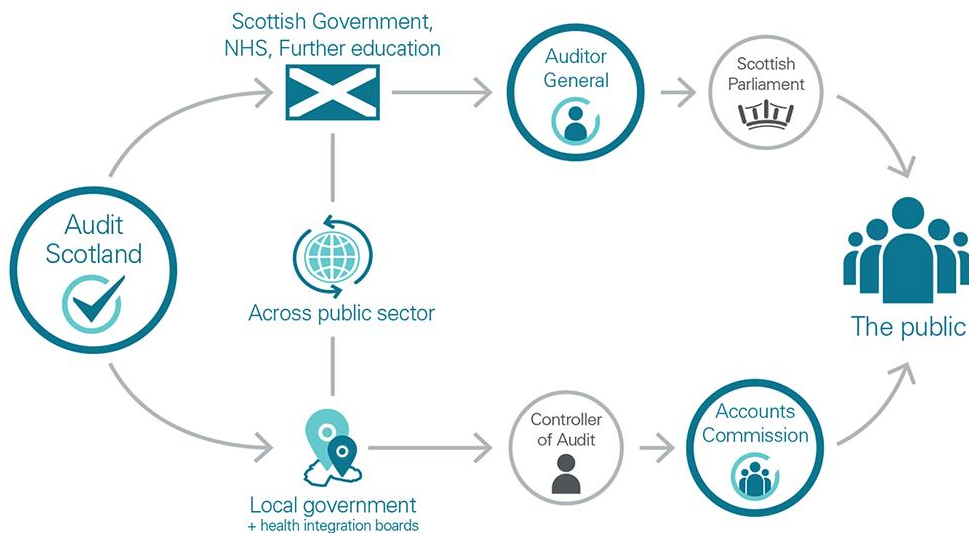


Prepared for East Renfrewshire Council
November 2018

Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non – executive board chair, and two non – executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Our vision is to be a world – class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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Introduction

1. This risk assessment was completed as part of Audit Scotland's housing benefit (HB) risk assessment programme. It does not represent a full audit of East Renfrewshire Council's benefit service.
2. The Local Government in Scotland Act 2003 introduced new statutory duties relating to Best Value and Community Planning. The key objective of the risk assessment is to determine the extent to which the benefit service is meeting its obligations to achieve continuous improvement in all its activities.
3. Specifically, the risk assessment considers the effectiveness of the benefit service in meeting national and local priorities, business planning and reporting, and delivering outcomes.
4. Information for this risk assessment was gathered from a range of sources including:
 - the self-assessment, supporting evidence, and updated action plan provided by the council
 - Department for Work and Pensions (DWP) indicators, and other performance measures
 - scrutiny of internal and external audit reports
 - discussions with the appointed external auditor and the council's internal auditor
 - discussions with senior officers in the council during our site visit in July 2018.

Risks identified

5. The key risks identified during our audit are highlighted within each section of the report. An action plan will be agreed with management and progress will be monitored as part of future benefit performance audits.
6. Any weaknesses identified represent those that have come to our attention during the course of normal audit work and therefore are not necessarily all the weaknesses that may exist. It is the responsibility of management to decide on the extent of the internal control system appropriate to East Renfrewshire Council.
7. The contents of this report have been discussed with relevant officers to confirm factual accuracy. The co-operation and assistance we received during the course of our audit is gratefully acknowledged

Executive summary

8. A risk assessment was previously carried out on the council's benefit service in July 2016 when Audit Scotland identified three risks that were outstanding from the previous risk assessment carried out in 2014 and three new risks to continuous improvement. This was reported to the Chief Executive in July 2016 and, in response, the council submitted an action plan in August 2016 to address the risks.
9. Since our last audit there has been some significant changes within the council. In October 2017 the council's benefit service merged with its Scottish Welfare Fund team to form the Benefits and Discretionary Payments Team. This new team is responsible for processing claims for HB, Council Tax Reduction, Scottish Welfare Fund applications, and discretionary housing payments.
10. In making this change the council aims to provide job security for staff, while ensuring that it delivers an efficient, effective and resilient benefits and discretionary payments service to customers at a time when budgets are being reduced and full-service Universal Credit (UC) is being rolled out.
11. During this period of change the council has remained proactive and committed in its efforts to improve service delivery. For example, by:
 - working in partnership with an external consultant in October 2017 to carry out a full review of its accuracy checking and overpayment recovery processes. As a result of this collaboration, a new management-checking framework was developed, and an additional £42k of overpayments was recovered in 2017/18 following a full review of overpayments that were being recovered from ongoing deductions of HB
 - engaging with the DWP's Performance Development Team (PDT) in December 2017 to establish the reasons for the decline in claims processing performance
 - employing temporary and agency staff to provide additional processing resources for the service.
12. In addition, the council introduced an online digital claims facility in February 2017 to allow customers to submit new claims online and, in August 2017, extended the functionality to allow customers to report a change event online.
13. As a relatively small council with a caseload of approximately 3,500 claims, resource management is an important aspect of service delivery. The loss of experienced staff, or high levels of sickness absence can have a significant impact on performance and, despite the council's continued efforts to improve service delivery, resourcing issues have had an adverse effect on claims processing times.

14. These have included significant levels of staff sickness absence and unfilled vacancies. In particular, between 2016/17 and 2017/18, sickness absence increased by 70% from 84 days to 141 days and, in the first three months of 2018/19 the service had lost another 58 days to sickness absence. As a consequence, the time taken to process claims has declined significantly since our last audit. This is discussed in more detail under *Speed of processing* at paragraph 23
15. To prepare for the DWPs roll out of full service UC on 26 September 2018, the council has established a UC Implementation Board chaired by the Head of Business Change & Revenue Services and is well positioned to ensure that it is prepared and ready to assist its customers during the transition to full service UC.
16. Although the council demonstrates awareness of what constitutes an effective, efficient and secure benefit service, there are five new risks arising from this risk assessment, and three risks outstanding from the previous risk assessment. To ensure continuous improvement, the council needs to address these risks. This includes:
 - addressing the reasons why the council's cumulative speed of processing performance for new claims, at an average of 31 days in 2017/18, is significantly above the DWPs most recent published Scottish average of 22 days, at 31 December 2017, and why change events performance has declined from an average of five days in 2017/18, to an average of nine days, at 30 June 2018
 - ensuring that the level of processing resource within the benefit service is sufficient to improve on current performance levels
 - ensuring the accuracy of the recorded time taken to process change events after an internal audit in May 2018 found that, in nine of 15 (60%) claims scrutinised, the actual time taken to process the change was, on average, 13 days more than that recorded on the benefit IT system
 - addressing the reasons for the significant decline in accuracy performance, and considering a more targeted approach to selecting cases for a management check to ensure the best use of limited resources, and to maximise the potential positive outcomes
 - improving the level of performance in respect of all debt recovery, which remains low when compared to other Scottish councils.
 - utilising Direct Earnings Attachments as an alternative means of recovering overpaid HB, to help further improve HB debt recovery performance.

Business planning and reporting

17. An effective business plan provides an opportunity for the council to set out the aims and objectives for each service and should contain key deliverables against which performance is measured, monitored and reported.
18. The *Revenues Service Plan 2017/18* is the key strategic document covering the work of the Benefits and Discretionary Payments team and details the service's focus which is to provide an efficient and effective service for the council, and to maximise income streams. Underpinning this are the service's key activities and performance indicators. Key activities include:
 - continuing to improve online forms so that customers can access the service digitally
 - supporting residents through the changes arising from Welfare Reforms and the rollout of UC
 - developing 'one notification' for council tax and benefit awards.
19. The key indicators for the Benefits and Discretionary Payments team include the:
 - time taken to process claims
 - accuracy of payments
 - time taken to deal with requests for reconsiderations and appeals
 - recovery of HB overpayments.
20. The service plan is updated six monthly by the Operations Manager and progress is reviewed by the Head of Service, Director and the Chief Executive at the mid-year and end-year points. Where key activities or performance are not on target, the Operations Manager is required to provide a detailed explanation.
21. In addition to the high-level review of the service plan, there is regular detailed reporting of HB performance at an operational level. This includes:
 - weekly focus meetings between the Head of Revenues and Business Change, the Revenues and Business Support Manager and the Operations Manager
 - fortnightly meetings between the Operations Manager and the Senior Revenues Officer
 - monthly 1-2-1 meetings between the Senior Revenues Officer and the Team Leader
 - monthly Revenues Management, Senior Management and Departmental Management team meetings
 - bi-monthly 1-2-1 meetings between the Benefits and Discretionary Payments Team Leader and team members.

22. The council also makes good use of an online performance management tool, which is updated six monthly by the Operations Manager and contains all the service's key performance indicators.

Delivering outcomes

23. Effective operational processes and IT systems, along with skilled staff, help benefit services deliver sound performance and continuous improvement. The council has a number of management arrangements in place to support this.

Speed of processing

24. When customers claim benefit, it is a time of financial uncertainty for them and, as such, it is essential that the service has sufficiently trained and effective benefit processors in place that can make informed decisions on complex benefit claims and pay benefit promptly.
25. Exhibit 1 illustrates the council's current and previous performance.

Exhibit 1: Speed of processing performance (average number of days)						
	2014/15	2015/16	2016/17	2017/18	2017/18 Scottish Average (Q3)	2018/19 (Apr-Jun)
New claims	27 days	24 days	32 days	31 days	22 days	31 days
Change events	7 days	4 days	5 days	5 days	9 days	9 days

Source: East Renfrewshire Council & DWP

26. Since our last audit, the council has been very proactive in its efforts to improve performance levels and has worked internally, and with key partners, to introduce a number of new initiatives and changes to processes and procedures. These include:
- introducing a generic approach to claims processing in 2016/17 by training HB staff to process claims from the public and private sector. Since the creation of the Benefits and Discretionary Payments team in October 2017 further cross training has been given to staff to provide more resilience and flexibility to the team and to provide opportunities for improvements in claims processing times
 - utilising external agents and temporary appointments to assist in the processing of new claims and change events. Throughout 2017/18 the service utilised a FTE agency processor, an additional FTE agency processor on an ad-hoc basis, and a FTE temporary processor. These contracts ended on the 31st March 2018. However, the council has secured the services of 2x FTE processors on a temporary contract until 31st March 2019, to help the service transition through the rollout of full service UC in September 2018

- introducing a digital online claims facility in February 2017 for new claims and extending the functionality in August 2017 to allow customers to report change events online. At the time of our audit, further functionality allowed customers to upload evidence in support of a change event, and the council advised that it was trialling the same upload functionality for new claims, with a view to offering customers a fully digital claims process
 - working with the DWPs PDT team in December 2017. The PDT scrutinised 18 new claims and reported no issues with processes or procedures, but concluded that a lack of resource was the main factor for the decline in the council's speed of processing performance
 - implementing the DWPs Verify Earnings and Pensions (VEP) service in 2017 and signing up to the enhanced alerts service which was due to go live in July 2018. The VEP service provides councils with:
 - real-time access to Her Majesty's Revenues and Customs (HMRC) records to verify a customer's earnings/pension details which should help reduce the time taken to establish a customer's income
 - real-time alerts to notify when a customer's income details have changed to ensure that a change can be processed timeously, therefore ensuring payment accuracy and reducing the potential for an overpayment to arise.
27. In addition, the council makes good use of the DWPs Automated Transfer to Local Authority Systems (ATLAS) service to automate approximately 77% of change event notifications received and advised that it was prioritising its workload to process new claims received with all information available, and claims that have been outstanding the longest, with the aim to clearing the current backlog of work.
28. As a relatively small council with a caseload of approximately 3,500 claims, resource management is an important aspect of service delivery. The loss of experienced staff, or high levels of sickness absence can have a significant impact on performance and, despite the council's continued efforts to improve service delivery, resourcing issues have had an adverse effect on claims processing times. These have included significant levels of staff sickness absence and unfilled vacancies. In particular, between 2016/17 and 2017/18, sickness absence increased by 70% from 84 days to 141 days and, in the first three months of 2018/19 the service had lost another 58 days to sickness absence.
29. In 2016/17, new claims processing performance declined significantly from an average of 24 days to an average of 32 days, while the time taken to process change events declined slightly from an average of four days to an average of five days. However, despite a significant increase in sickness absence in 2017/18, new claims performance improved slightly to an average of 31 days, while the time taken to process change events was maintained at an average of five days.

30. In the first quarter of 2018/19, while maintaining the time taken to process new claims at an average of 31 days, the time taken to process change events had declined to an average of nine days. This level of performance placed the council 28th in Scotland for the time taken to process new claims and 19th for the time taken to process change events, when compared to the DWP's 2017/18 quarter three published performance statistics.
31. In addition, following an internal audit of the benefit service in May 2018, the auditor reported that, in nine claims (60%) out of a sample of 15 claims selected at random where a change event had been processed, the date on the benefit IT system, used to determine the time taken to process the change, had been incorrectly recorded.
32. Audit Scotland's analysis of this sample established that, had the council recorded the correct date of the change, the time taken to process each of the nine claims would have been, on average, 13 days more than that recorded and subsequently reported to the DWP. In accepting the findings of the internal auditor, the benefit service has reacted promptly to provide remedial training to staff.
33. However, based on the high level of error found in the internal audit sample, the council cannot take assurance that its reported speed of processing performance in respect of change events is accurate until it carries out further work to establish the extent of the problem.

Risks to continuous improvement

1	The council needs to address the results of the findings of the internal audit in May 2018 to provide assurance that its reported performance in respect of the time taken to process change events is accurate.
2	The level of processing resource within the benefit service might not be sufficient to significantly improve on current below target performance levels.

34. Audit Scotland identified one risk to continuous improvement that was originally carried forward from our audits in 2014 and 2016 in that the council's cumulative new claims speed of processing performance, at an average of 30 days in 2014, and an average of 24 days in 2016, remained above the Scottish average at the time of the audits.
35. In view of the council's current level of new claims processing performance, which at an average of 31 days for new claims in 2017/18 remains well above the Scottish average of 22 days, based on the DWPs 2017/18 quarter three published performance statistics, we consider that this risk remains outstanding.

Accuracy

36. The accurate and secure administration of HB should be a key priority for every council, and to support this, it should have a robust quality assurance framework in place.

37. The council places significant importance on the quality and accuracy of its claims processing activities and historically has delivered a high level of performance in this area. In 2014/15 and 2015/16 the service reported its financial accuracy rate at 99%. However, in 2016/17, accuracy performance declined significantly to 93%.
38. To understand and address the reasons for the decline, in October 2017, the council worked in partnership with an external consultant to carry out a full review of its management checking framework. This review found that the council's focus on targeting many of its checks on new staff and staff that were under-performing was introducing a negative bias which, despite claims being corrected before payment, had resulted in the decline in reported performance.
39. As a result of this review, a new management checking framework was implemented in April 2018 with the aim to ensure that all management checks are selected randomly from the benefit IT system and carried out wherever possible before a payment and notification letter are issued. A new post-payment check of 300 claims per year was also introduced to specifically record the financial accuracy of the live caseload.
40. Management checks are carried out by the Benefits and Discretionary Payments Team Leader and two Lead Officers. This should provide the service with flexibility and resilience to ensure that checks are routinely carried out. On a daily basis the service aims to carry out a pre-payment and pre-notification check on a minimum of 2% of decisions selected randomly from the live HB system.
41. A comprehensive audit check form is used to record the outcomes of these checks and, where an error is identified the officer is advised of the error and asked to correct the claim. When the claim has been amended the checking officer ensures that the appropriate corrective action has been taken before signing off the check on the audit form, which is then retained on the electronic workflow system to ensure a complete audit trail of actions taken.
42. The outcomes from management checks are recorded electronically, summarised and analysed to identify any trends or patterns of error. Where an officer is making recurring errors the Team Manager, or one of the Team Leaders provides guidance and support which could involve assisting in the processing of a similar claim to ensure that the officer is aware of the reasons for the error, and how to correct it. Where there is a pattern of error across the service, the Senior Revenues Officer would provide remedial training as appropriate.
43. In addition to the 2% daily pre-payment checks, new staff are subject to a 100% check of their work which is reduced incrementally until the officer is considered to be competent. There is also a 100% check of all payments in excess of £1500 and, where an error is found, the payment can be recalled before issue to the customer.
44. The service regularly reports accuracy performance to staff and senior management through:
 - bi-monthly 1-2-1 meetings between the Team Leader and team members

- the Revenues Service Plan, which is updated six-monthly and reviewed by the Head of Service, Director and Chief Executive
- the council's online performance management framework, which is available to view by senior management and updated six-monthly by the Operations Manager.

45. Exhibit 2 illustrates the council's current and previous accuracy performance.

Exhibit 2: Financial accuracy performance		
	Internal Target	Achieved
2013/14	98%	99%
2014/15	97%	99%
2015/16	98%	99%
2016/17	98%	93%
2017/18	100%	77%
2018/19 (at 30 Sep 2018)	100%	90%

Source: East Renfrewshire Council

46. Although the council had been proactive in its efforts to address the decline in accuracy in 2016/17, the council advised that accuracy performance declined significantly in 2017/18 as a result of the underperformance of some members of staff.
47. Although the decline in performance is of concern, it highlights the importance of targeted checks over random checks as the service had been focussing its resources on staff that were causing most errors and seeking to resolve this by providing additional support and guidance.
48. If the council decides to fully adopt the random checking approach as detailed in the new management checking framework, we consider that there is an increased likelihood that under-performing staff might avoid checks of their work, and that checks could be carried out on low-risk claims that have been passported from the DWP.
49. Passported claims are where the customer's entitlement to HB is provided by entitlement to a qualifying DWP benefit. As these claims are considered to be less complex, it could be reasonably assumed that the DWP has carried out the necessary checks on their customer's entitlement to the qualifying benefit and therefore more beneficial for the benefit service to carry out management checks on more complex claim types where recurring errors are most found.

50. Audit Scotland identified the following risks to continuous improvement during our previous audit in 2016 in that:
- the council needed to review and recommence its programme of management checks as soon as possible and have robust arrangements in place to ensure that management checks were routinely carried out to minimise the potential for fraud and error to enter the system.
 - there was limited analysis of management check outcomes and therefore the council was missing an opportunity to identify trends and patterns of error that could help identify areas for learning and development of staff and the service.
51. We consider that both these issues have been addressed as the council has recommenced its management checks, carries out detailed analysis of the outcomes, and worked in partnership with an external consultant in October 2017 to carry out a full review of its processes and procedures.

Risks to continuous improvement	
3	The council needs to address the reasons for the decline in accuracy performance.
4	The council should consider a more targeted approach to selecting cases for a management check to ensure the best use of limited resources and to maximise the potential for positive outcomes.

Interventions

52. To minimise error in the caseload, councils must encourage customers to report change events on time and have a robust intervention programme to identify changes and take appropriate corrective action.
53. To support this, the benefit service notification letters remind customers of the requirement to report any change event. In addition, the council's website provides customers with details of office opening hours, information on how to contact the benefit service by telephone, letter, or e-mail, and an online change event form that is fully automated.
54. The council also actively participates in the DWP's Housing Benefit Matching Service, Audit Scotland's National Fraud Initiative, the DWP's Real Time Information (RTI) and optional RTI data matching services, and more recently the DWP's VEP service. These should all help to identify possible unreported change events that require further investigation.
55. On a daily basis the service makes good use of the benefit IT system diary facility to highlight claims where future changes are expected or known, which could affect the customer's entitlement to benefit, for example, a significant birthday or a change in household details.

56. Exhibit 3 below details the outcomes from the council's normal interventions activity.

Exhibit 3: Interventions performance				
	Number of completed interventions	Number of decreases in HB identified	Number of increases in HB identified	% resulting in a change to benefit
2015/16	480	100	35	28%
2016/17	16	10	1	68%
2017/18	77	40	8	62%
2018/19 (at July 2018)	61	27	8	57%

Source: East Renfrewshire Council

57. Since our last audit there has been a significant reduction in the number of proactive interventions carried out. However, in 2016/17, with limited resources and a decline in claims processing performance, a decision was taken to reduce proactive interventions activity and focus resources on improving claims processing times.
58. Since 2016/17, proactive interventions activity has focussed on an annual review of customers in receipt of a work/private pension. In the most recent exercise carried out in May 2018, 121 review forms were issued, and, at the time of our audit, 61 forms had been returned and fully reviewed.
59. Of these, 57% had resulted in a change to the amount of HB paid, which indicates that the council is effectively targeting cases where the customer has not declared a change in their circumstances. This activity also helps the council to identify overpayments that may otherwise have gone undetected, and to ensure that customers that are entitled to more benefit receive their correct entitlement.
60. While the outcomes from interventions are recorded on the benefit IT system, the system can only record whether there has been an increase, decrease, or no change to benefit. As such, it was not possible for the council to fully analyse the outcomes of interventions in order to inform the scope and focus of future intervention campaigns.
61. Audit Scotland identified one risk to continuous improvement that was carried forward from our audit in 2014 in that:
- the council did not have a formalised interventions strategy and had not recorded or analysed the outcomes from its interventions activity since 2011/12. In order to ensure that resources are being used to best effect, and to help inform future intervention

strategies, the council should fully document its interventions approach, and link intervention outcomes to the value of overpayments/underpayments identified.

62. The council told us that it had engaged with its benefit IT system supplier with a view to improving the level of intervention information that can be recorded on the system, however at the time of our audit it had been unable to progress this satisfactorily due to the supplier's other business priorities and commitments.
63. In view of this, and as the council does not have an intervention strategy, was not fully documenting its approach, and was not linking interventions outcomes to the value of overpayments/underpayments identified, we consider that this risk remains outstanding.

Overpayments

64. To protect public funds, councils should take appropriate steps to ensure that benefit overpayments are minimised and that, when they do occur, they are correctly classified and rigorously recovered.
65. The *Corporate Debt Policy*, approved by members in June 2016, details the council's approach to the recovery of outstanding debt and has a stated commitment to maximise the collection of debts owed, minimise write offs, and wherever possible assist customers by minimising any additional recovery costs.
66. The policy aims include:
 - developing a council wide approach to debt collection
 - ensuring a professional, timely, and consistent approach to recovery action
 - reducing the levels of debt owed to the council
 - treating customers consistently and fairly and ensuring that their rights are protected.
67. To minimise HB overpayments, the benefit service prioritises change events that could lead to an overpayment, uses benefit IT system reports to predict changes, and reminds customers wherever possible of the need to report any changes. In addition, the council checks the output from the DWPs ATLAS system daily and prioritises claims where an overpayment could arise.
68. This proactive approach has helped minimise the number of local authority (LA) /administrative error overpayments that can arise as a result of processing delays. This is particularly important as a council can lose subsidy where its LA/administrative error rate exceeds 0.48% of all HB payments made. Since 2014/15, the council has been well below this threshold, which is commendable.
69. Where it is not possible to recover an overpayment from ongoing benefit entitlement, the debt is passed to the Corporate Debt Recovery team (CDRT) who issue an invoice to the

customer, followed by a reminder, and a final notice. Where no response is received after the final notice stage, the debt recovery team makes good use of all available recovery options including:

- utilising the DWP's Payment Deduction Programme to automate the recovery of HB overpayments from DWP benefits, where appropriate
- using the DWP's Customer Information System to trace customers who are no longer resident within the local authority area
- working in partnership with other councils to recover an overpayment from ongoing benefit received by the customer in another council area
- utilising Sheriff's Officers for difficult to recover debt.

70. Exhibit 4 illustrates the council's current and previous recovery performance.

Exhibit 4: Overpayment levels and recovery performance				
	2014/15	2015/16	2016/17	2017/18
Total HB overpayments carried forward	£1,189,729	£1,232,391	£1,451,055	£1,550,356
Total overpayments identified in-year	£395,284	£442,902	£398,230	£376,760
Total value of HB debt	£1,585,013	£1,675,293	£1,849,285	£1,927,116
Total value of HB debt recovered	£230,512	£224,238	£228,103	£268,000
% of in-year debt recovered	58%	51%	57%	71%
% of total HB debt recovered	15%	13%	12%	14%

Source: East Renfrewshire Council

71. Historically, the council's level of debt recovery has been low when compared to other Scottish councils where Audit Scotland regularly sees all debt recovery rates in excess of 20% and in-year recovery rates in excess of 60%.
72. The council recognised this as an area for improvement and, in October 2017, worked in partnership with an external consultant to carry out a full review of its overpayments processes and procedures. The review was concluded in February 2018 and resulted in a number of changes designed to improve recovery rates supported by a set of protocols developed by the council in January 2017 to standardise its approach.
73. The *HB Debt Protocol* underpins the *Corporate Debt Policy* and is a set of 11 protocols setting out the council's approach to recovering HB overpayments. These include:
 - legal compliance - in all respects the council's approach must always be legally compliant
 - assertive transparency - ensuring the debtor is aware that recovering debt helps to fund public services while highlighting to the debtor the potential consequences of defaulting on payments or not engaging with the council
 - optimal rate of recovery - ensuring that the maximum recovery rate is set in all cases, except those that could result in financial hardship for the customer
 - fairness - treating all customers fairly and equitably
 - full asset utilisation - making good use of all available resources and technology to aid in the recovery of debt.
74. As part of the review by the external consultant, the council analysed 380 claims where the overpayment of HB was being recovered from ongoing deductions of benefit. This analysis found that 315 (83%) customers had been repaying their debt at less than the maximum allowed rate of £11.10, with an average weekly repayment rate of £5.75 and, in 254 of the 380 cases (67%), the weekly recovery rate was less than £5.75.
75. The council took immediate action to address this by contacting affected customers and advising that recovery rates would be increased to £11.10 per week. Customers were also advised at this time that due consideration, and advice and assistance would be available if the proposed increase would cause hardship.
76. As a result of this action, the council improved its in-year and all debt recovery performance by recovering an additional £42,000 of overpaid benefit in 2017/18.
77. To help further improve recovery rates, the council has signed up to the recently launched DWP HB Debt Service project. This service allows councils to send up to 1,200 dormant HB overpayments per month to the DWP to match with real time HMRC employment and pension data.

78. At the time of our audit, the council had sent an initial batch of 77 cases for matching and was reviewing the 34 cases that had been returned. Although it is too early to assess how successful this will be, it is another aspect of the recovery process that the council can fully utilise to help deliver further improvements in recovery performance.
79. Audit Scotland identified one risk from our previous audit in 2016, and one risk carried forward from our 2014 audit in that:
- the information in respect of benefit overpayment recovery performance that is provided by the CDRT to senior management does not provide sufficient information for the council to determine the effectiveness of its approach or provide assurance that it is meeting its debt recovery policy aims
 - with the exception of in-year recovery performance for 2014/15, the council's performance in respect of recovering benefit debt is considered well below normal recovery rates.
80. We consider that the first risk has now been addressed as the benefit service receives monthly reports from the CDRT providing a breakdown of payments received and debts outstanding. However, despite an improved recovery performance in 2017/18, the council's level of performance in respect of all debt recovery remains low when compared to other Scottish councils and therefore we consider that this risk remains outstanding.

Risk to continuous improvement

5	The council is not utilising Direct Earnings Attachments as a means of recovering overpaid HB and is therefore missing an opportunity to further improve its debt recovery performance.
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Appendix A

Progress against action plan agreed after previous benefit audit in 2016, as at March 2018	
The council needs to review and recommence its programme of management checks as soon as possible and have robust arrangements in place to ensure that management checks are routinely carried out to minimise the potential for fraud and error to enter the system.	Completed
There is limited analysis of management check outcomes and therefore the council is missing an opportunity to identify trends and patterns of error that could help identify areas for learning and development of staff and the service.	Completed
The information in respect of benefit overpayment recovery performance that is provided by the CDRT to senior management does not provide sufficient information for the council to determine the effectiveness of its approach or provide assurance that it is meeting its debt recovery policy aims.	Completed
With the exception of in-year recovery performance for 2014/15, the council's performance in respect of recovering benefit debt is considered well below normal recovery rates.	Outstanding
The council's cumulative speed of processing performance for new claims and change events remains higher than the Scottish average time taken, at 31 October 2014.	Outstanding
The council does not have a formalised interventions strategy and has not recorded or analysed the outcomes from its interventions activity since 2011/12. In order to ensure that resources are being used to best effect, and to help inform future intervention strategies, the council should fully document its interventions approach, and link intervention outcomes to the value of overpayments/underpayments identified.	Outstanding

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East Renfrewshire CouncilAudit of Housing BenefitAction Plan November 2018

Risk number	Description of risk	Action to be taken	Officer Responsible	Timescale for completion
1	The council needs to address the results of the findings of the internal audit in May 2018 to provide assurance that its reported performance in respect of the time taken to process change events is accurate.	Team members were all provided with DWP's speed of processing (SOP) document and refresher training was provided in July 2018. This is an area closely reviewed during the accuracy checking process. Should any issues arise whilst carrying out the accuracy checks, these will be immediately addressed. Any repeat issues identified will be subject to an improvement plan. Plans are in place to do a further refresher training session on this in 2019/20	Benefits and Discretionary payments Team leader	Complete. Area subject to ongoing monitoring
2	The level of processing resource within the benefit service might not be sufficient to significantly improve on current below target performance levels.	Resource is being reviewed at present to establish the requirements for the team going forward.	Senior Revenues Manager	September 2019
risk c/f from 2016 audit	In view of the council's current level of new claims processing performance, which at an average of 31 days for new claims in 2017/18 remains well above the Scottish average of 22 days, based on the DWPs 2017/18 quarter three published performance statistics, we consider that this risk remains outstanding	Resource levels are currently being reviewed in the team as are performance levels.	Senior Revenues manager	September 2019

Risk number	Description of risk	Action to be taken	Officer Responsible	Timescale for completion
3	The council needs to address the reasons for the decline in accuracy performance.	The reasons for lower rates of accuracy in 2017/18 have been addressed. We have an improved accuracy checking regime in place, which to some extent is limiting the number of claims processed. Accuracy will continue to be reviewed as a priority area.	Senior Revenues officer	In place
4	The council should consider a more targeted approach to selecting cases for a management check to ensure the best use of limited resources and to maximise the potential for positive outcomes.	A new management checking framework will be developed which will not be based on random sample checking, and will be more targeted.	Senior Revenues officer	May 2019
risk c/f from 2016 audit	The council does not have a formalised interventions strategy. In order to ensure that resources are being used to best effect, and to help inform future intervention strategies, the council should fully document its interventions approach, and link intervention outcomes to the value of overpayments/underpayments identified.	There is ongoing intervention activity carried out using the resource available from optional real time information (RTI) , verifications of earnings and pensions (VEPS). The service acknowledges that the results from intervention activity are not analysed in detail. This area will be investigated further including implications for resourcing.	Operations Manager	December 2019
c/f from 2016 audit	With the exception of in-year recovery performance for 2014/15, the council's performance in respect of recovering benefit debt is considered well below normal recovery rates	A number of improved processes have been implemented in the last year to 18 months and these have improved in year recovery rates. Targeted approaches on the aged debts will now be investigated and implemented	Senior Revenues Officer (NT) & corporate debt team leader	June 2019

Risk number	Description of risk	Action to be taken	Officer Responsible	Timescale for completion
5	The council is not utilising Direct Earnings Attachments as a means of recovering overpaid HB and is therefore missing an opportunity to further improve its debt recovery performance.	This will be taken forward as part of a wider review of our Debt Recovery Policy which will then be taken to Cabinet for approval	Operations Manager	September 2019

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EAST RENFREWSHIRE COUNCILAUDIT AND SCRUTINY COMMITTEE21 February 2019Report by ClerkNATIONAL EXTERNAL AUDIT REPORTWITHDRAWAL FROM THE EUROPEAN UNION – KEY AUDIT ISSUES
FOR THE PUBLIC SECTOR**PURPOSE OF REPORT**

1. To provide information on the Audit Scotland report *Withdrawal from the European Union – Key Audit Issues for the Public Sector*.

RECOMMENDATION

2. It is recommended that the Committee considers the report.

BACKGROUND

3. A copy of the Audit Scotland report *Withdrawal from the European Union – Key Audit Issues for the Public Sector*, published in October 2018, has already been circulated to all Audit and Scrutiny Committee Members. Under the Committee's specialisation arrangements, the Members leading the review of this particular report are Councillor Miller and Councillor Grant. The Chief Executive has provided comments on the report and a copy of that feedback is attached (see Appendix).

RECOMMENDATION

4. It is recommended that the Committee considers the report.

Local Government Access to Information Act 1985

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Background Papers:-

1. Audit Scotland report *Withdrawal from the European Union – Key Audit Issues for the Public Sector*

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EAST RENFREWSHIRE COUNCILAUDIT AND SCRUTINY COMMITTEE21st February 2018Report by Chief ExecutiveEAST RENFREWSHIRE COUNCIL'S RESPONSE TO AUDIT SCOTLAND REPORT –
WITHDRAWAL FROM THE EUROPEAN UNION REPORT**PURPOSE OF REPORT**

1. The purpose of this report is to provide East Renfrewshire Council's response to key audit issues for the Scottish Public Sector raised in the Audit Scotland - Withdrawal from the European Union Report; circa October 2018.

RECOMMENDATIONS

2. It is recommended that the Audit and Scrutiny Committee note:
 - the key issues raised in the Audit Scotland Report;
 - the Council's responses to the key questions for public bodies raised in the report, based around Audit Scotland's themes of, 'people', 'finance' & 'rules and regulations';
 - Audit Scotland's plans for audit over the short and long term; and
 - The Council's preparedness for Brexit.

BACKGROUND

3. The UK will leave the European Union (EU) on 29th March 2019. If the UK Government and the EU agree terms for the withdrawal before this date; there will be a transition period until the end of 2020. In the event of a 'no deal' Brexit, there will be no transition period.
4. Audit Scotland advises that withdrawal from the EU comes at the same time as the significant expansion of the Scottish Parliament's powers, rising demand for public services and continued pressures on public sector budgets.
5. The report presents Audit Scotland's view of key issues that withdrawal from the EU presents to public bodies, at October 2018. It raises questions that councils should be considering in the run up to 29th March 2019 and finally sets out Audit Scotland's plans to reflect withdrawal from the EU in their audit work.

REPORT

6. Some of the key issues for public sector bodies are set out below and reflect Audit Scotland's plans for its future audit work.

7. The UK's exit from the EU is likely to result in changes to the rights of non-UK EU nationals who live, work and study and access services across East Renfrewshire. The Council's responses, stated below, demonstrate how we plan to communicate, support and respond to implications that may affect local work forces when the UK leave the EU.
8. Under the finance theme, Audit Scotland states there is little clarity about what will happen to funding streams in the longer term. Any changes to funding will affect public bodies and potential implications or loss of EU funding continues to be reflected in long term financial planning. Our response to Audit Scotland's questions under this theme lays out the work the Council is doing to ensure EU withdrawal has the minimum impact on our funding.
9. All public bodies have to comply with EU regulations such as employment law, health and safety legislation and procurement rules. The EU (Withdrawal) Act 2018 means that from 29th March 2019, EU law will no longer take precedent over UK law. However; the Act copies most European law into UK law, meaning that the existing legal framework will continue and the impact on bodies is expected to be minimal.
10. The information within this report sets out Audit Scotland's key questions for public sector bodies under each of its themes and the Council's response to each theme.

PEOPLE

11. The EU Settlement Scheme will allow EU citizens and their families to continue to live and work in the UK, if they meet the requirements and want to apply. Public bodies have been working hard to understand the immediate and longer term implications of EU withdrawal on their workforces. East Renfrewshire Council is no exception. Work has been undertaken to understand the nature and impact that leaving the EU will have on those employees who are EU citizens living and working here. Fifty two Council employees have been identified as non UK-EU nationals. These employees will need to apply to the EU Settlement Scheme to continue to live and work in the UK; however the Government has now announced that the EU Settlement Scheme fees have been scrapped and that there will be no cost for employees or citizens who need to apply.
12. The Council will signpost employees to the Home Office application process and will use Home Office materials to do so. It has been agreed that communications will be made generically to the workforce and managers will be asked to cascade the information. This is to ensure that no employee is missed and to also ensure employees who have family members who are EU nationals, are also aware of the changes. In addition departments will speak to employees who have been identified as EU nationals to ensure they understand the application process.
13. The Home Office has developed an employer's toolkit and a Local Authority toolkit is also under development. The information contained in these will form the basis of all communications with employees and a Communication plan has been developed, which will be launched in February 2019 to update managers and employees on the EU Settlement Scheme. This will be communicated via email, intranet and posters where appropriate.

14. The Home Office has also launched up to £9 million of grant funding, available to voluntary and community sector (VCS) organisations to help vulnerable or at-risk EU citizens needing additional support when applying for the EU Settlement Scheme (EUSS). East Renfrewshire Culture and Leisure Trust (ERCL) is submitting a proposal as to how they can support the diversity of needs of an EU citizen population to make their EUSS applications through the local libraries. "WeAreDigital" provided the service in England and Wales and are looking for organisations to provide this support on their behalf in Scotland, ERCL have signed a memorandum of understanding with them. The application period for bids closed on 1 February 2019. If successful this service will also be promoted to employees.
15. It is difficult at this time to know what affects leaving the EU will have on East Renfrewshire's long term workforce planning. However the Council continues to work to understand the impact on its workforce and those who provide services with and on its behalf.
16. There are workforce implications for third and private sector organisations that provide services in partnership with us or on our behalf. Whilst it is not possible to know the full extent of the impact at this time, work has been ongoing locally with our employability team, WorkEastRen and local employers to further explore workforce resilience and retraining of the local workforce. The end of Free Movement on Brexit should not affect existing people from the European Union working here and will not prevent them from continuing in their paid roles, however; they will need to establish their immigration status by July 2021. There is some concern around volunteers. The position is less clear as they do not derive income from their charity work or any other funds. They may qualify economically as self-sufficient, but will have to prove access to funds if they are to remain in the UK.
17. The area within the Council workforce with the highest number of EU nationals is the Education department. For teaching, there may well be an impact on supply teacher numbers. However, it is not expected to impact on the quality of provision. Nationally there will be a need to ensure the appropriate numbers of teachers are trained with a focus on retention within the teaching profession. There is not expected to be any risk to Facilities Management as there are regular recruitment events where there is a high volume of applicants to fill all positions.
18. From a social care perspective, work has been undertaken locally and we are engaged with WorkER to look at opportunities for further collaboration; making care an attractive career choice for people, both in terms of school leavers and individuals who have taken a career break for caring or other family reasons. We are also placing greater emphasis on creating opportunities to design and organise care services at a locality level, which will support the local economy, and may go some way to addressing any short term uncertainty around EU withdrawal.
19. East Renfrewshire has a service based economy, which does not appear to have a high dependency of EU nationals. We continue to engage with local businesses and suppliers to evaluate risks to areas such as homecare and will encourage them to promote the EU settlement scheme to mitigate against any impact of EU withdrawal.
20. We continue to reflect implications for the local workforce in our economic strategies by consistently reviewing workforce needs. Through our commissioning strategies and locality planning processes we are already anticipating changes to the workforce as a consequence of known changes to our demography. We will continue to look at how we will contract for services locally to create a more sustainable market.

FINANCE

21. EU funding provides direct support for many areas. There is little clarity about what will happen to funding streams in the longer term. EU funding streams are dedicated to specific activities and can be targeted at specific geographic areas. Audit Scotland advises that this may change in the future and by way of example states, if any replacement funding is to be incorporated into the Scottish Government's block grant; it will be for the Scottish Government to decide whether to protect funding that is currently ring fenced for specific activities/areas.

22. The financial risks to local authorities are considered to be significant due to the nature of some EU funding streams, namely, ESF funds. This is because local authorities match fund 50% contributions against that funding.

23. East Renfrewshire Council's level of funding from the EU at this juncture is split across European Social Fund, European Regional Development Fund, and the LEADER programme as follows:

Phase 1 – December 2015 – December 2019

- European Social Fund - £1,471,250
- European Regional Development Fund - £160,000
- LEADER Programme - £1.1m (shared between East Renfrewshire Council, Inverclyde and Renfrewshire Council on a project needs basis)

Phase 2 of the European Programmes – January 2019 – December 2022

- European Social Fund - £1,566,740.00
- European Regional Development Fund - £160,000

24. East Renfrewshire will continue with projects associated with this grant funding until expiry of the respective scheme. However, following Brexit we will be unable to apply for any new EU funding. It is not known at this time whether the UK Government plan to provide this kind of grant funding in the future.

25. Whilst it is known that the third sector receives funding directly from EU institutions, it is unclear what impact a 'no deal' Brexit would have on future funding opportunities for the sector.

26. East Renfrewshire Council has, for many years, undertaken long term financial planning and is factoring in any potential implications prompted by the outcome of Brexit, during this period. The Council and the Corporate Management Team will continue to:

- closely monitor developments;
- assess the potential impact withdrawal from the EU will have on our organisation; and
- put in place plans to take appropriate action as required.

27. East Renfrewshire Council continues to be in dialogue with UK and Scottish Governments and COSLA about a 'Prosperity Fund' to replace European Structural Funds. Whilst this is in its infancy there has been no detail, to date, on budgets, eligibility criteria, individual local authority share etc.

RULES AND REGULATIONS

28. Audit Scotland state that EU rules and regulations will affect all public bodies, with the most significant being trade and custom rules, which influence the cost and availability of supplies from EU countries. If the UK Government and EU do not agree trade arrangements before the end of March 2019, goods entering the UK will be subject to additional customs checks and trade tariffs. This could, in effect, lead to an increase in food prices and affect budgets, for example, in schools.
29. Audit Scotland ask what the potential implications of changes to trade and customs rules to our supply chains and the cost and availability of products and services could be in East Renfrewshire.
30. EU regulations/legislation that is directly relevant to the Council covers the majority of Trading Standards and Environmental Health Legislation. The EU (Withdrawal) Act 2018 copies most European law into UK law and it is expected that the relevant amendment regulations will take care of the transition of EU legislation. The situation in relation to consumer rights in the event of a deal being reached is that consumer rights will be covered under the withdrawal agreement until it ends. Things may well be different in the event of a no deal and East Renfrewshire Council will continue to have a key role in providing advice to local business.
31. Audit Scotland asks what impact potential changes to regulations/legislation would have on how we deliver services and our service users.
32. East Renfrewshire Council and its Partners continue to plan for the possibility of the UK Government and EU failing to reach an agreement on arrangements for the UK's exit from the EU. East Renfrewshire Crisis Management and Resilience Team will lead on critical areas of work and consider all possible scenarios to mitigate risks to the Council and its services. East Renfrewshire's Chief Executive and the Chair of the Crisis Management and Resilience Team attended the West of Scotland Resilience Workshop in early February 2019 and will continue to monitor the situation in line with UK and Scottish Government guidance.

CONCLUSION

33. Although the outcome of Brexit negotiations is not yet clear and there may be a "no deal" Brexit, the Council will continue to assess the potential impact withdrawal from the EU will have on our organisation. Whilst the uncertainty has created challenges, we will continue to identify specific risks and develop plans to respond to them through our Crisis Management and Resilience Team and Civil Contingency Planning processes. The Corporate Management Team and the Council is as prepared as far as possible for potential outcomes discussed in the Audit Scotland Report.
34. The impact of EU withdrawal will feature in Audit Scotland's work plan for the foreseeable future. It is planned, in the short term to report on public bodies responses to withdrawal from the EU as part of the 2018/19 audits. Audit Scotland's planned performance audits will consider the impact of withdrawal from the EU where relevant. 2019 audit is likely to include challenges, performance, skills, planning and investment. A longer term work programme, for the five years from 2019/20, will include specific performance audits on arrangements following withdrawal from the EU.

RECOMMENDATIONS

35. It is recommended that the Audit and Scrutiny Committee note:

- the key issues raised in the Audit Scotland Report;
- the Council's responses to the key questions for public bodies raised in the report based around Audit Scotland's themes of, 'people', 'finance' and 'rules and regulations';
- Audit Scotland's plans for audit over the short and long term; and
- The Council's preparedness for Brexit.

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February 2019

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