

Report

Report to:	Finance and Corporate Resources Committee
Date of Meeting:	15 November 2017
Report by:	Executive Director (Finance and Corporate Resources)

Subject:	Treasury Management Activity – Second Quarter Review
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1. Purpose of Report

1.1. The purpose of the report is to:-

- ♦ provide a second quarter review of Treasury Management Activity for 2017/2018

2. Recommendation(s)

2.1. The Committee is asked to approve the following recommendation(s):-

- (1) that the contents of this report be noted.

3. Background

3.1 In order to provide members with information on the Council's Treasury Management activities, a quarterly report is presented to this Committee. This report covers the period 1 April to 30 September 2017.

4. Market Performance

- 4.1. As at 30 September 2017, the UK Base Rate was at 0.25% and the Bank of England Asset Purchase Programme (commonly referred to as its policy of quantitative easing) remained at £435bn.
- 4.2. On 2 November 2017, the Bank of England's Monetary Policy Committee (MPC) voted to increase the UK Base Rate to £0.50%.

5. Debt Management and Borrowing Strategy

- 5.1. The Council began the year with debt of £928.489m with fixed rate loans from the Public Works Loans Board (PWLB) making up 98.94% of the debt.
- 5.2. Table 1 overleaf shows the movement in borrowing to 30 September 2017. Short term borrowing reflects borrowing which will mature in the coming year, or where the debt can be recalled in the coming year.

Table 1 – Movement in Borrowing to 30 September 2017

	Balance as at 01/04/2017 £m	New Borrowing £m	Debt Maturing £m	Debt Repaid £m	Balance as at 30/09/2017 £m	Increase/ Decrease in Borrowing £m
Short Term Borrowing	24.325	0.00	(13.151)	0.00	11.174	(13.151)
Long Term Borrowing	904.164	0.00	0.00	0.00	904.164	0.00
TOTAL BORROWING	928.489	0.00	(13.151)	0.00	915.338	(13.151)

- 5.3. In 2012/2013, HM Treasury introduced a “certainty rate” to enable eligible local authorities to access cheaper PWLB funding, with a 20 basis point (0.20%) reduction on the standard rate. South Lanarkshire Council has access to this reduced rate.
- 5.4. The Council has a borrowing requirement of £161.943m during 2017/2018.
- 5.5. The Executive Director (Finance and Corporate Resources), under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into consideration the differential between investment earnings and debt costs that remain high.
- 5.6. The Council’s strategy for managing debt includes the early repayment of some loans within the Loans Fund. These repayments result in reduced principal and interest payments in future years and are necessary to keep loan charges affordable.
- 6. Investment Activity**
- 6.1. On a daily basis, the Treasury Management section within Finance and Corporate Resources manages the Council’s cash funds. These cash balances can result from day to day cash flow situations where income has been received before expenditure has taken place, and from the balances held in earmarked reserves for use at a later date. It is the responsibility of the section to manage these funds. The primary consideration when making deposits is the security of funds. Then consideration is given to ensuring we have access to funds when necessary, and that these funds are working as well as they can for the Council.
- 6.2. The Prudential Indicators, Treasury Management Strategy and Annual Investment Strategy Report for 2017/2018 was presented to South Lanarkshire Council (Special) on 16 February 2017 detailing permitted investments for this Council.
- 6.3. The Council undertakes significant scrutiny of any counterparty that we place money with in partnership with our Treasury Advisers, Capita. This includes information on counterparty credit ratings and details of negative rating watches. Additional market information on counterparties is also considered including share prices, market research information and risk data in the form of Credit Default Swap prices. Only when we are satisfied that there are no issues that raise any concerns about the security of the deposit would the deposit go ahead.
- 6.4. Deposits made in the period 1 April 2017 to 30 September 2017 totalled £534.551m. This is the cumulative deposits placed over this period. This is broken down per sector and institution in Table 3 below. 83.39% of these deposits were made in the UK Government through the Debt Management Office (DMO) deposit facility.

Deposits in the UK Government are considered to be the most secure and this is reflected in the low interest rate for deposits in the DMO.

- 6.5. Local authorities borrow from other local authorities for short term cash flow reasons. This would appear as a deposit for South Lanarkshire Council when another council has borrowed from us.

Table 2 – Investment Activity 1 April 2017 to 30 September 2017

Counterparty	Deposit Totals (£m)	% of Total Deposits	Average Interest Rate
Deposits in UK Government			
Debt Management Account Deposit Facility	445.750	83.39%	0.10%
Treasury-Bills	11.999	2.24%	0.14%
Total Deposits in UK Government	457.749	85.63%	0.10%
Deposits in UK Local Authorities	57.600	10.78%	0.15%
Deposits in UK Banks and Building Societies:			
Bank of Scotland	19.202	3.59%	0.15%
Total Deposits in UK Banks and Building Societies	19.202	3.59%	0.15%
Total Deposits 01/04/2017 to 30/09/2017	534.551	100.00%	0.11%

- 6.6. The average interest rates achieved from the deposits are shown in Table 2. As the base rate has been at, or below, 0.5% since March 2009, interest rates achievable from deposits remain low.
- 6.7. Actual deposits as at 30 September 2017 totalled £96.903m.

7. Management of Risk

- 7.1. It is recognised that no Treasury Management activity is without risk and practices are put in place in order to limit risk. In February 2017, the Treasury Management Strategy was approved which set a framework for Treasury Management activities in 2017/2018 and limits on debt and investments in order to mitigate risks.
- 7.2. The Annual Investment Strategy for 2017/2018, approved in February 2017, also included details on how risk would be managed for all permitted investments. This included criteria for placing deposits with the Debt Management Office, UK Local Authorities, Banks and Building Societies and Money Market Funds.
- 7.3. Part of the criteria for counterparties is meeting minimum credit ratings with the three main rating agencies. A credit rating evaluates the credit worthiness of an organisation. It is an evaluation made by a credit rating agency of the organisation's ability to pay back the debt and the likelihood of default.
- 7.4. Tables 3 to 5 show a breakdown of deposits with details of the credit ratings of banks and building societies used from 1 April 2017 to 30 September 2017. Deposits with the DMO are with the UK Government and so have a rating equivalent to the UK's sovereign rating. Deposits with local authorities are considered to be of very high credit quality.

Table 3 – Fitch Ratings

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
Deposits in DMO (AA)		457.749m	85.63%
Deposits with Local Authorities		57.600m	10.78%
A+	F1	19.202m	3.59%
Total		534.551m	100.00%

Table 4 – Moody's Ratings

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
Deposits in DMO (Aa1)/(Aa2)		457.749m	85.63%
Deposits with Local Authorities		57.600m	10.78%
A1	P-1	19.202m	3.59%
Total		534.551m	100.00%

Table 5 – Standard and Poor's Ratings

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
Deposits in DMO (AA)		457.749m	85.63%
Deposits with Local Authorities		57.600m	10.78%
A	A-1	19.202m	3.59%
Total		534.551m	100.00%

- 7.5. The tables above show that 96.41% of deposits were made with counterparties of very high credit quality (UK Government DMO account, T-Bills and other local authorities).
- 7.6. The remaining deposits were in a call account with Bank of Scotland.
- 7.7. The graph at Appendix 1 shows the duration of deposits made from 1 April 2017 to 30 June 2017. The graph shows that, since 1 April 2017, all deposits have been made for 1 year or less. The maximum maturity period of 49 days was for a deposit of £3m with Dumfries and Galloway Council.
- 8. Next Quarter Investment Plans**
- 8.1. The current investment framework will be continued in the next quarter. Deposits will continue to be placed with the institutions where their ratings are consistent with the Council's approved criteria. Deposits will also continue to be placed with the DMO and UK local authorities.
- 8.2. Treasury Bills will be used when they return a higher yield than deposits in the DMO for the same, very low risk.
- 8.3. Deposits may also be placed with selected Money Market Funds that meet the Council's approved criteria.
- 8.4. We will continue to work with our Treasury Advisers, Capita, to ensure we gain all information available on counterparties before any deposits are made.

9. Treasury Management Indicators

- 9.1. The purpose of these indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However, if these are set to restrictive limits, they will impair the opportunities to reduce costs/improve performance. The indicators are detailed below.
- 9.2. **Limits on Fixed / Variable Rate Exposure** - Setting an upper limit on fixed and variable rate exposure identifies a limit for exposure to fixed and variable rates of interest. The purpose of this indicator is to provide a measure of stability against the adverse effects of market fluctuations. The levels will allow us to undertake variable / fixed or Equal Instalment of Principal (EIP) borrowing to take full advantage of current interest rates. This is shown in Table 6 below.

Table 6 – Limits on Fixed/Variable Rate Exposure

	Indicator	Maximum for period to 30/09/17
Upper limit of fixed rate exposures	180%	112.69%
Upper limit of variable rate exposures	30%	0.75%

- 9.3. The indicator shows that the upper limits have not been breached to 30 September 2017.
- 9.4. The actual fixed rate exposure is assessed by comparing the amount of Net Debt (which is borrowing less investments) we hold at a fixed rate to the Total Net Debt (both fixed and variable) of the Council. The same is calculated for variable rate exposure. An illustration of this calculation is shown in Table 7 below using figures for debt and investments as at 30 September 2017.

Table 7 – Calculation of Fixed/Variable Rate Exposure as at 30 September 2017

	£m		£m
Total Debt	915.338		
Less Total Investments	(96.903)		
= Total Net Debt	818.435		
Fixed Net Debt		Variable Net Debt	
Fixed Debt	905.838	Variable Debt	9.500
Less Fixed Investments	(0.000)	Less Variable Investments	(96.903)
= Fixed Net Debt	905.838	= Variable Net Debt	(87.403)
Exposure	110.68%	Exposure	(10.68%)
(Fixed Net Debt / Total Net debt)		(Variable Net Debt / Total Net debt)	

- 9.5. **Limits for External Debt** - The operational and authorised limits for external debt for 2017/2018 were set in the Prudential Indicators, Treasury Management Strategy and Annual Investment Strategy 2017/2018 approved by South Lanarkshire Council on 16 February 2017. These are shown in Table 8 overleaf, along with a column showing the difference between the actual debt level and the limits (headroom).

Table 8 – Limits for External Debt

	Estimate as per 2017/18 Strategy	Minimum Headroom to Limits in period	Headroom as at 30/09/17
	£m	£m	£m
Operational Limit for external debt	1,150.000	221.511	234.662
Authorised Limit for external debt	1,170.000	241.511	254.662

- 9.6. The indicator shows that we have not breached the operational and authorised limits to 30 September 2017. There has been a minimum level of headroom of £241.511m between actual and authorised level for external debt.
- 9.7. **Limits on Maturity Structure** - By setting limits on the maturity structure of fixed rate borrowing, the exposure to large concentrations of fixed rate debt needing to be replaced at the same time in the future at currently unknown rates can be limited. This effectively places a limit on exposure to longer term interest rate movement. This is shown in Table 9 below.

Table 9 – Limits on Maturity Structure

Maturity Structure of Fixed Rate Borrowings				
	Upper Limit	Lower Limit	Maximum for period to 30/09/17	Actuals as at 30/09/17
Under 12 months	15%	0%	2.65%	1.23%
12 months and 24 months	20%	0%	2.47%	2.47%
24 months and 5 years	50%	0%	9.87%	9.87%
5 years and 10 years	50%	0%	13.00%	13.00%
10 years and 20 years	60%	0%	33.36%	33.36%
20 years and 30 years	70%	0%	2.45%	2.45%
30 years and 40 years	80%	0%	32.73%	32.73%
40 years and 50 years	90%	0%	4.89%	4.89%
50 years and above	90%	0%	0.00%	0.00%

- 9.8. The indicator shows that the upper limits for all maturity profiles have not been breached to 30 September 2017.

10. Employee Implications

- 10.1. There are no employee implications.

11. Financial Implications

- 11.1. The current rate of interest receivable remains low.
- 11.2. Any deposit interest received offsets Loan Charges made to the Council's Revenue budget. The level of deposit interest factored into the Council's budget is minimal, therefore, the low level of interest received will have no impact on existing budgets.
- 11.3. The costs of borrowing for capital expenditure have been built into the long term Revenue Budget Strategy.

12. Other Implications

- 12.1. Section 7 of this report provides details of how investment risk is managed.
- 12.2. There are no implications in terms of sustainability.
- 12.3. There is no requirement to carry out an environmental impact assessment in terms of the information contained within this report.

13. Equality Impact Assessment and Consultation Arrangements

- 13.1. This report does not introduce a new policy, function or strategy or recommend a change to an existing policy, function or strategy and, therefore, no impact assessment is required.
- 13.2. There is no requirement to carry out any consultation in terms of the information provided in this report.

Paul Manning

Executive Director (Finance and Corporate Resources)

17 October 2017

Link(s) to Council Values/Objectives

- ♦ Accountable, effective and efficient

Previous References

- ♦ Prudential Indicators, Treasury Management Strategy and Annual Investment Strategy 2017/2018, South Lanarkshire Council, 16 February 2017
- ♦ Treasury Management Activity – First Quarter Review, Finance and Corporate Resources Committee, 6 September 2017

List of Background Papers

- ♦ None

Contact for Further Information

If you would like to inspect the background papers or want further information, please contact:-

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