Agenda Item

Report

13

Report to:	**Finance and Information Technology Resources Committee**
Date of Meeting:	**27 October 2009**
Report by:	**Executive Director (Finance and Information Technology Resources)**

Subject:	**Treasury Management Investment Activity – Quarterly Report**

1. Purpose of Report

1.1. The purpose of the report is to:-

- Provide a quarterly update of South Lanarkshire Council's investments, and information on how we manage our risk.
- Provide comments on how the market is performing.
- Provide details of projected cash flow and the investment framework that will be applied in the forthcoming quarter.

2. Recommendation(s)

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

(1) that they note the content of the report regarding investments
(2) that they note the management of risk
(3) that they note the investment framework that will be used in the next quarter.

3. Background

3.1. On a daily basis the Treasury Management section within Finance and Information Technology Resources manages the Council's surplus cash funds. These cash balances can result from day to day cash flow issues where income has been received before expenditure has taken place, and from the balances held in reserves. It is the responsibility of the section to invest these funds. The primary consideration when making investments 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.

3.2. Currently Treasury Management reports are provided to this Committee twice a year. Last year our auditors, PricewaterhouseCoopers (PwC), undertook an assessment of our Investment Risk Management Framework. That report proposed we report to Committee quarterly on our investments, and the management of investment risk.

3.3. At present the Council undertakes significant scrutiny of investment counterparties in partnership with our Treasury Advisers prior to investment. This includes information on counterparty credit ratings, negative rating watch details and whether they are part of the UK Government Credit Guarantee Scheme. Additional market information on counterparties is also provided.

This includes share prices, market research information, and risk data in the form of Credit Default Swap prices which show how expensive it is to insure against a counterparty defaulting. The higher the price, the greater the perceived risk. Only when we are satisfied that there are no issues that raise any concerns about the security of the investment, would the deposit go ahead.

4. Investment Activity

4.1. As this is the first report to be presented to Committee investments data will be shown from 01 April 2009 to 31 August 2009. Going forward, only activity per quarter will be detailed in each report.

4.2. Investments made in the period 01 April 2009 to 31 August 2009 totalled £515.630m. This is broken down per sector and institution in Table 1 below. 48% of these investments were made in the UK Government through the Government's Debt Management Office (DMO) deposit facility. Rates of interest paid by the DMO are the lowest of all counterparties, but is the most secure counterparty.

Table 1

Counterparty	Investment Totals	Percentage of Total Investments	Average Interest Rate
Investments in UK Government	**£247.240m**	**48%**	**0.287%**
Investments in UK Local Authorities	**£109.700m**	**21%**	**0.334%**
Investments in UK Banks: Royal Bank of Scotland Lloyds TSB Barclays Bank PLC	 £79.690m £20.000m £19.000m		
Total Investments in UK Banks	**£118.69m**	**23%**	**0.597%**
Investments in UK Building Society: Nationwide Building Society	 £20.000m		
Total Investments in UK Building Society	**£20.000m**	**4%**	**0.955%**
Investments in UK Subsidiaries of Foreign Banks: Abbey (Part of Santander Group, Spain) Clydesdale Bank (Part of National Australia Bank)	 £10.000m £10.000m		
Total Investments in UK Subsidiaries of Foreign Banks	**£20.00m**	**4%**	**1.445%**
Total Investments 01/04/09 to 31/08/09	**£515.630m**	**100%**	**0.4079%**

4.3. The average interest rates achieved from the deposits are shown in Table 1. As the base interest rate has sat at 0.5% since March 2009, interest rates achievable from investments are considerably lower than in previous years.

4.4. Credit ratings of counterparties are monitored alongside other indicators to ensure their security, and to ensure they meet our investment policy. The credit ratings of counterparties used from 01 April to 31 August are detailed below in Table 2. A key to what each of the ratings mean is attached at Appendix 1.

4.5. The table shows 69% of deposits were made with AAA rated counterparties (UK Government DMO account and other local authorities).

4.6. The counterparty at the foot of the table with Individual Rating E is the Royal Bank of Scotland. The rating reflects the need for UK Government assistance to keep the bank afloat. The support rating of 1 shows the support the bank will continue to receive from the UK Government.

Table 2

Long Term Rating	Short Term Rating	Individual Rating	Support Rating	Investment Totals	Percentage of Total Investments
AAA				£356.940m	69%
AA-	F1+	A/B	2	£20.000m	4%
AA-	F1+	B	1	£19.000m	4%
AA-	F1+	B	2	£10.000m	2%
AA-	F1+	B/C	1	£10.000m	2%
AA-	F1+	E	1	£99.690m	19%
Total				**£515.630m**	

4.7. Treasury Management guidelines do not allow any investment to be made for more than 364 days. The terms of each fixed investment are recorded for each deal made. The graph at Appendix 2 shows the duration of fixed term investments that have been made.

4.8. The graph shows that since the start of the financial year most investments have been made for less than 3 months. This is to ensure that we are reasonably able to react to any change in the banking environment and are not committed with any one institution for excessive periods.

4.9. Deposits in Instant Access Call Accounts comprise to Royal Bank of Scotland Special Interest Bearing Accounts (SIBA) and Abbey accounts, each with a limit of £10m. As both these accounts pay the highest interest rate available, we endeavour to ensure that the use of these accounts is maximised in the first instance.

5. Management of Risk

5.1. It is recognised that no Treasury Management activity is without risk, and practices are put in place in order to limit risk.

5.2. The maximum amount able to be invested in an AAA counterparty is limited to £15m, and for an AA- counterparty the limit is £10m. This shows that the Council are being prudent in how much it is willing to invest in a single institution. By spreading the risk in this way, we are limiting the value of potential loss, should the institution fail. As well as using credit ratings further data is sought as detailed at Section 3.3 before any investment is made.

5.3. The Council maintains a policy for choosing investment counterparties with adequate security and monitoring it. This allows us to restrict deposits to specific organisations. The current approved criteria for Counterparties are:-

Banks/Building Societies

Criteria	Max Amount	Max Period
Minimum F1 short term, backed up by AAA long term, and support rating of 2 or individual rating of B	£15m	364 days
Minimum F1 short term, backed up by AA- long term, and support rating of 2 or individual rating of B	£10m	364 days
Minimum F1 short term, backed up by A- long term, and support rating of 2 or individual rating of B	£5m	364 days

Local Authorities, Joint Boards and Passenger Transport Executives

Criteria	Max Amount	Max Period
Local Authorities, Joint Boards and PTE	£15m	364 days

Debt Management Office Deposit Facility

Criteria	Max Amount	Max Period
Debt Management Office Deposit Facility	£80m	364 days

5.4. The Council is currently applying a very cautious approach to investment using banks as counterparties allowing deposits to be placed only to institutions who are able to access the Government's Credit Guarantee Scheme. Whilst the scheme is not a guarantee on deposits it does reflect the Government's commitment to providing stability to these banking institutions if required.

6. Market Performance

6.1. The UK Base Rate has remained at the historically low level of 0.5% and the Bank of England has introduced additional, unconventional measures of buying back assets in an attempt to increase the supply of money, lower borrowing costs and stimulate the economy.

7. Projected Cash Flow

7.1. The council's cash flow reflects the day to day cash position experienced. The daily cash position is dependent on income received and expenditure made on any given day.

7.2. Projected cash flow for the quarter 01 September 2009 to 31 December 2009 is detailed graphically in Appendix 3 to the report. The graph shows a daily cash flow position moving between positive and negative balances.

7.3. The cumulative cash flow line shows that a decrease of £121.369m in cash balances is expected over the three month period. This will reduce our cash deposits to zero. During this time deposits will be placed in order to achieve liquidity to meet our cash flow obligations.

7.4. Borrowing for the Council's capital programme will have to be taken before the end of the year. Consideration is being given to the best time to borrow to ensure the borrowing rates we receive are attractive, whilst avoiding holding cash balances for an unnecessary period of time attracting poor interest returns. Any borrowing will affect the cash flow position and increase the level of investments we have.

8. Next Quarter Investment plans

8.1. It is proposed that the current investment framework is continued in the next quarter. Investments will continue to be placed with the institutions where their ratings are consistent with the Council's approved criteria and their access to the UK Government's Credit Guarantee Scheme is continued.

8.2. We will continue to work with our Treasury Advisers, Arlingclose, to ensure we gain all information available on counterparties before any investments are made.

8.3. Consultation has recently closed on proposed Investment Regulations for Scotland. These regulations will allow Local Authorities to undertake a wider range of investments. Any form of investment will be made legal through the regulations (including shares, property, money market accounts) however all planned investments must be reported to Committee a part of an annual Investment Strategy.

8.4. The results of the consultation, and the date the subsequent Regulations will be effective from has still to be announced. Further updates will be made to this Committee as they become available.

9. Employee Implications

9.1. There are no employee implications.

10. Financial Implications

10.1. The current rate of interest payable is very low in comparison to previous years. This is a direct result of the base rate reductions made over recent months.

10.2. Deposit interest received offsets Loan Charges made to the Council's Revenue budget. Currently no account of deposit interest is factored into the Council's budget and therefore the low level of interest received will have no impact on existing budgets.

11. Other Implications

11.1. There are no other implications.

12. Equality Impact Assessment and Consultation Arrangements

12.1. 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.

12.2. There is no requirement to carry out any consultation in terms of the information contained in this report.

Linda Hardie
Executive Director (Finance and Information Technology Resources)

5 October 2009

Link(s) to Council Values and Objectives
- Accountable, effective and efficient

Previous References
- 19 May 2009 Finance and Information Technology Resources Committee
- 7 July 2009 Finance and Information Technology Resources Committee

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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Fitch Credit Rating Definitions

Fitch provides a rating for four individual aspects of an organisation. Within each rating, different grades are applied to reflect the strength of the organisation.

- Short term rating – focuses on the liquidity to meet financial commitments (within a 12 month timetable)
- Long term rating – has a time horizon greater than 12 months and measures the capacity to meet financial commitments
- Individual rating – assess how a bank would be viewed if it were entirely independent and could not rely on external support
- Support rating – assess the likelihood of the bank receiving financial support in the event of difficulties.

Fitch Short Term Ratings

F1: Highest short-term credit quality.
Indicates the strongest intrinsic capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature.

F2: Good short-term credit quality.
Good intrinsic capacity for timely payment of financial commitments.

F3: Fair short-term credit quality.
The intrinsic capacity for timely payment of financial commitments is adequate.

Fitch Long Term Ratings

AAA: Highest credit quality.
'AAA' ratings denote the lowest expectation of default risk. They are assigned only in cases of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.

AA: Very high credit quality.
'AA' ratings denote expectations of very low default risk. They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.

A: High credit quality.
'A' ratings denote expectations of low default risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.

BBB: Good credit quality.
'BBB' ratings indicate that expectations of default risk are currently low. The capacity for payment of financial commitments is considered adequate but adverse business or economic conditions are more likely to impair this capacity.

Fitch Individual Ratings

A: A very strong bank. Characteristics may include outstanding profitability and balance sheet integrity, franchise, management, operating environment or prospects.

B: A strong bank. There are no major concerns regarding the bank. Characteristics may include strong profitability and balance sheet integrity, franchise, management, operating environment or prospects.

C: An adequate bank, which, however, possesses one or more troublesome aspects. There may be some concerns regarding its profitability and balance sheet integrity, franchise, management, operating environment or prospects.

D: A bank that has weaknesses of internal and/or external origin. There are concerns regarding its profitability and balance sheet integrity, franchise, management, operating environment or prospects. Banks in emerging markets are necessarily faced with a greater number of potential deficiencies of external origin.

E: A bank with very serious problems, which either requires or is likely to require external support.

F: A bank that has either defaulted or, in Fitch Ratings' opinion, would have defaulted if it had not received external support. Examples of such support include state or local government support, (deposit) insurance funds, acquisition by some other corporate entity or an injection of new funds from its shareholders or equivalent.

Fitch Support Ratings

1: A bank for which there is an extremely high probability of external support. The potential provider of support is very highly rated in its own right and has a very high propensity to support the bank in question.

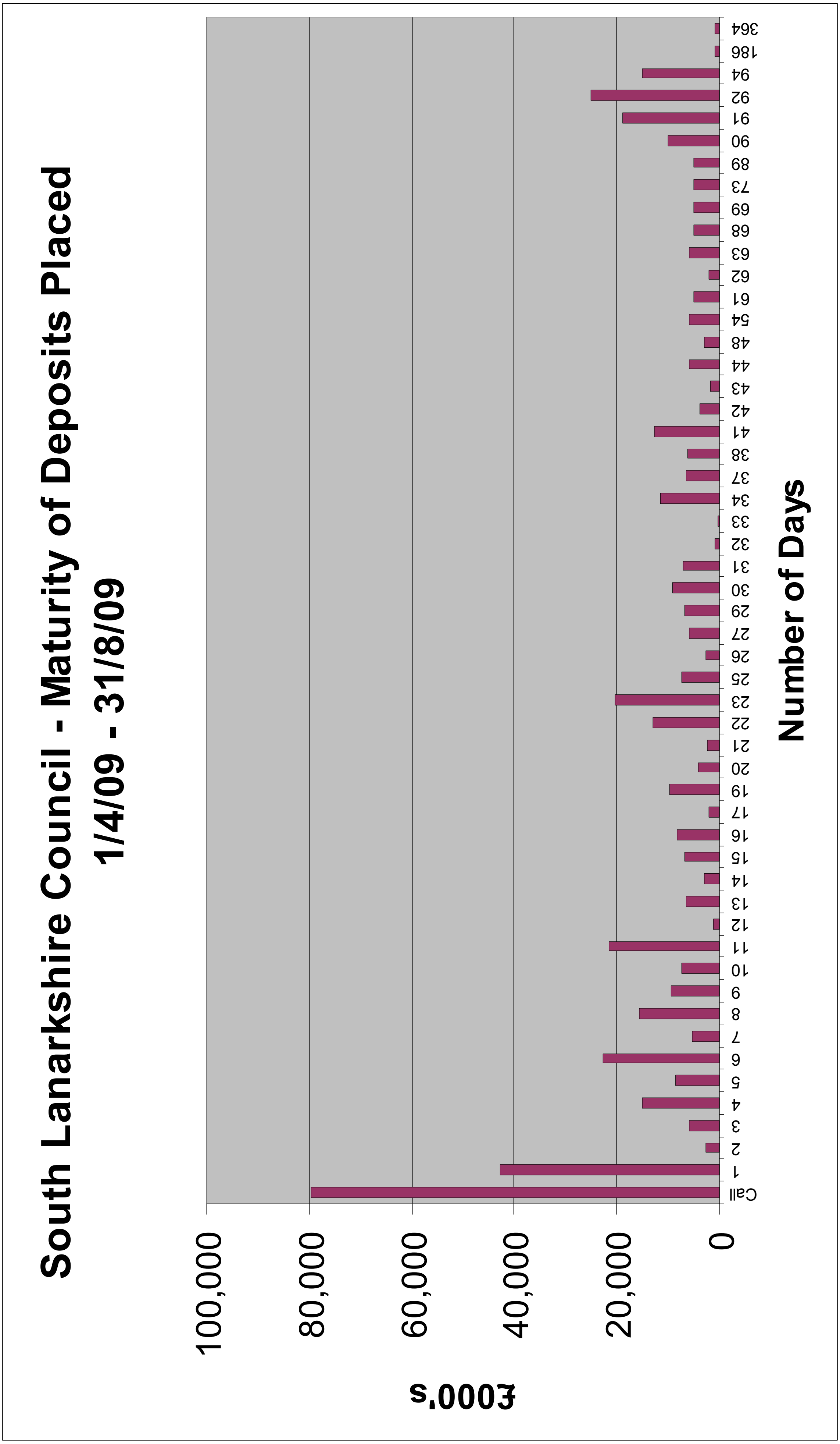
2: A bank for which there is a high probability of external support. The potential provider of support is highly rated in its own right and has a high propensity to provide support to the bank in question.

3: A bank for which there is a moderate probability of support because of uncertainties about the ability or propensity of the potential provider of support to do so.

4: A bank for which there is a limited probability of support because of significant uncertainties about the ability or propensity of any possible provider of support to do so.

5: A bank for which external support, although possible, cannot be relied upon. This may be due to a lack of propensity to provide support or to very weak financial ability to do so.

Appendix 2



South Lanarkshire Council - Maturity of Deposits Placed
1/4/09 - 31/8/09
£000's
100,000
80,000
60,000
40,000
20,000
0
Call
1
2
3
4
5
6
7
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10
11
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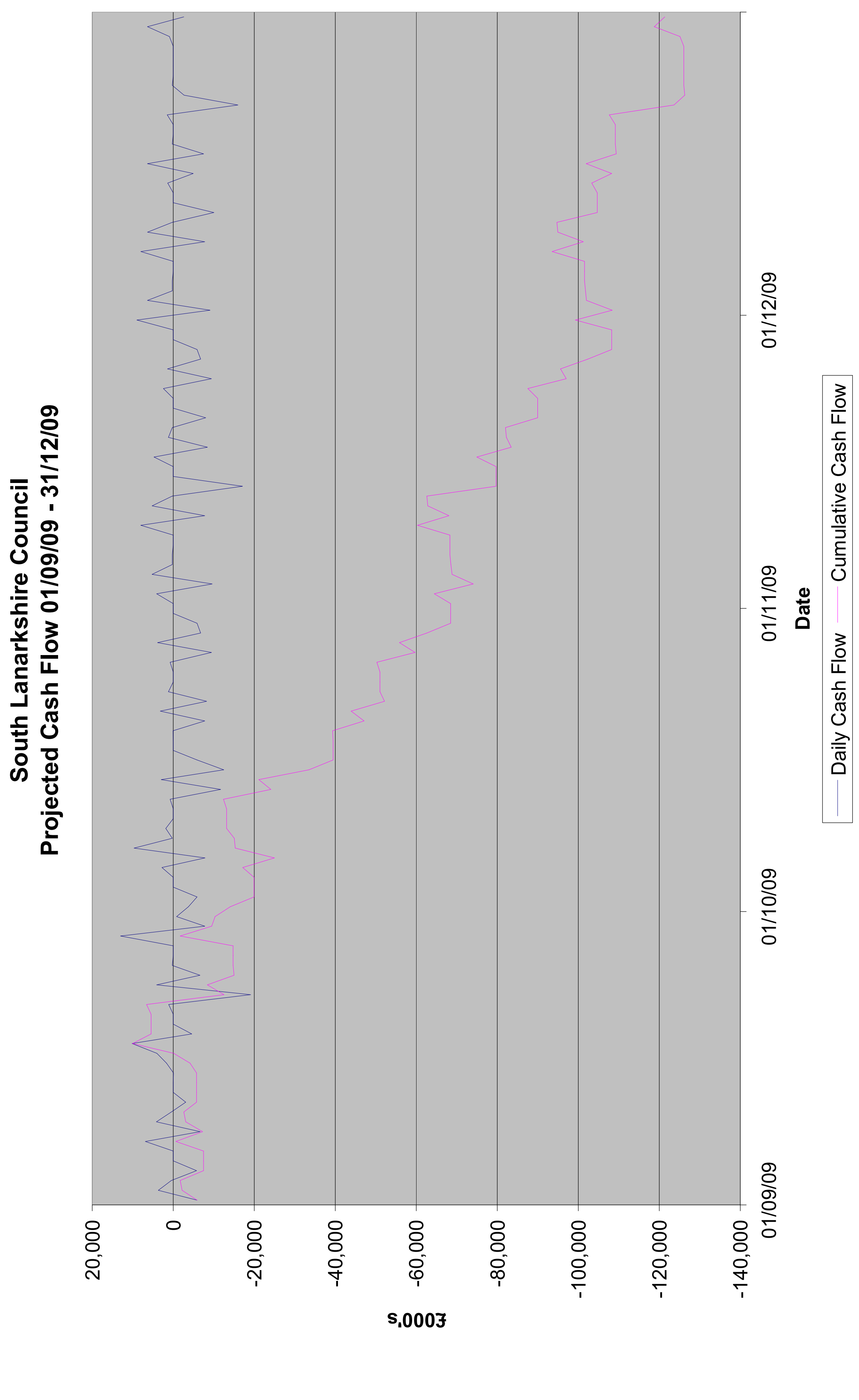
186
364
Number of Days

Appendix 3



South Lanarkshire Council
Projected Cash Flow 01/09/09 - 31/12/09
£000's
20,000
0
-20,000
-40,000
-60,000
-80,000
-100,000
-120,000
-140,000
01/09/09
01/10/09
01/11/09
01/12/09
Date
Daily Cash Flow
Cumulative Cash Flow