

Report

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| Report to: | Finance and Corporate Resources Committee |
| Date of Meeting: | 20 January 2021 |
| Report by: | Executive Director (Finance and Corporate Resources) |

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| 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 2020/2021

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 2020 to 30 September 2020.

4. Market Performance

- 4.1. After the Bank of England left the base rate unchanged at 0.75% in January 2020, the onset of the coronavirus epidemic in March forced it into making two emergency cuts, first to 0.25% and then to 0.10%.
- 4.2. As at 30 September 2020, the base rate remained at 0.10% and the Bank of England Asset Purchase Programme (commonly referred to as its policy of quantitative easing) was £745bn.
- 4.2. The Council's Treasury Management Advisers are predicting no further changes in the UK Base Rate during the remainder of 2020/2021.

5. Debt Management and Borrowing Strategy

- 5.1. The Council began the year with debt of £1,035.433m with fixed rate loans from the Public Works Loans Board (PWLB) making up 99.12% of the debt.
- 5.2. Table 1 shows the movement in borrowing to 30 September 2020. 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 2020

| | Balance as at 01/04/2020 £m | New Borrowing £m | Debt Maturing £m | Debt Repaid £m | Balance as at 30/09/2020 £m | Increase/ Decrease in Borrowing £m |
|----------------------------|-----------------------------------|------------------------|------------------------|----------------------|-----------------------------------|--|
| Short Term Borrowing | 29.893 | 0.000 | (29.357) | 0.00 | 0.536 | (29.357) |
| Long Term Borrowing | 1,005.540 | 0.000 | 0.00 | 0.00 | 1,005.540 | 0.000 |
| TOTAL BORROWING | 1,035.433 | 0.000 | (29.357) | 0.00 | 1,006.076 | (29.357) |

- 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 £80.306m during 2020/2021.
- 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 remains high.
- 5.6. No borrowing has been taken so far in the current financial year. Instead, cash balances have been used to fund capital spend. Borrowing to replace these balances will be required going forward.
- 6. Investment Activity**
- 6.1. On a daily basis, the Treasury Management section within Finance and Corporate Resources manages the Council’s cash balances. These 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. Secondary to this, 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 2020/2021 was approved by the Chief Executive under delegated authority in consultation with the Group Leaders on 25 March 2020. This included details of permitted investments for the Council.
- 6.3. The Council undertakes significant scrutiny of any counterparty that we place money with in partnership with our Treasury Management Advisers, Link. 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 2020 to 30 September 2020 totalled £1,096.245m. This is the cumulative deposits placed over this period. This is broken down per sector and institution in Table 3. 73.95% of these deposits were made in the UK Government through the Debt Management Office (DMO) deposit facility.
- 6.5. In order to manage their cash flow over the short term, local authorities, as part of normal treasury management activity, will place money on deposit with other local authorities. Deposits placed with other local authorities account for 19.61% of deposits with the remaining 6.44% placed in a call account with Bank of Scotland.
- 6.6. 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.

Table 3 – Investment Activity 1 April 2020 to 30 September 2020

| Counterparty | Deposit Totals (£m) | % of Total Deposits | Average Interest Rate |
|--|----------------------------|----------------------------|------------------------------|
| Deposits in UK Government | | | |
| Debt Management Account Deposit Facility | 810.660 | 73.95% | 0.03% |
| Total Deposits in UK Government | 810.660 | 73.95% | 0.03% |
| Deposits in UK Local Authorities | 215.000 | 19.61% | 0.14% |
| Deposits in UK Banks and Building Societies: | | | |
| Bank of Scotland | 70.585 | 6.44% | 0.04% |
| Total Deposits in UK Banks and Building Societies | 70.585 | 6.44% | 0.04% |
| Total Deposits 01/04/2020 to 30/09/2020 | 1,096.245 | 100.00% | 0.05% |

- 6.7. The average interest rates achieved from the deposits are shown in Table 3. As the base interest rate has been at, or below, 0.75% since March 2009, interest rates achievable from deposits during the first quarter remained low.
- 6.8. Actual deposits as at 30 September 2020 totalled £254.250m.

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 March 2020, the Treasury Management Strategy was approved which set a framework for Treasury Management activities in 2020/2021 and limits on debt and investments in order to mitigate risks.
- 7.2. The Annual Investment Strategy for 2020/2021, approved in March 2020, 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 4 to 6 show a breakdown of deposits with details of the credit ratings of banks and building societies used from 1 April 2020 to 30 September 2020. 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 4 – Fitch Ratings

| Long Term Rating | Short Term Rating | Deposits Totals | Percentage of Total Deposits |
|-----------------------------------|-------------------|-------------------|------------------------------|
| Deposits with UK Government (AA-) | | 810.660m | 73.95% |
| Deposits with Local Authorities | | 215.000m | 19.61% |
| A+ | F1 | 70.585m | 6.44% |
| Total | | 1,096.245m | 100.00% |

Table 5 – Moody's Ratings

| Long Term Rating | Short Term Rating | Deposits Totals | Percentage of Total Deposits |
|-----------------------------------|-------------------|-------------------|------------------------------|
| Deposits with UK Government (Aa2) | | 810.660m | 73.95% |
| Deposits with Local Authorities | | 215.000m | 19.61% |
| Aa3 | P-1 | 70.585m | 6.44% |
| Total | | 1,096.245m | 100.00% |

Table 6 – Standard and Poor's Ratings

| Long Term Rating | Short Term Rating | Deposits Totals | Percentage of Total Deposits |
|----------------------------------|-------------------|-------------------|------------------------------|
| Deposits with UK Government (AA) | | 810.660m | 73.95% |
| Deposits with Local Authorities | | 215.000m | 19.61% |
| A+ | A-1 | 70.585m | 6.44% |
| Total | | 1,096.245m | 100.00% |

- 7.5. The tables above show that 93.56% of deposits were made with counterparties of very high credit quality (UK Government DMO account 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 2020 to 30 September 2020. The graph shows that, since 1 April 2020, all deposits have been made for 1 year or less. The maximum maturity period of 273 days was for a deposit of £6.000m.

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 Management Advisers, Link, 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 in sections 9.2 to 9.5.
- 9.2. **Limits for External Debt:** The operational and authorised limits for external debt for 2020/2021 were set in the Prudential Indicators, Treasury Management Strategy and Annual Investment Strategy 2020/2021 approved by the Chief Executive under delegated authority in consultation with the Group Leaders on 25 March 2020. These are shown in Table 7, along with a column showing the difference between the actual debt level and the limits (headroom).

Table 7 – Limits for External Debt

| | Estimate as per 2020/21 Strategy | Minimum Headroom to Limits in period | Headroom as at 30/09/2020 |
|-------------------------------------|---|---|--|
| | £m | £m | £m |
| Operational Limit for external debt | 1,270.000 | 234.567 | 263.924 |
| Authorised Limit for external debt | 1,290.000 | 254.567 | 283.924 |

- 9.3. The indicator shows that we have not breached the operational and authorised limits to 30 September 2020. There has been a minimum level of headroom of £254.567m between actual and authorised level for external debt in the period to 30 September 2020.
- 9.4. **Limits on Maturity Structure:** By setting limits on the maturity structure of borrowing, the exposure to large concentrations of 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 8.

Table 8 – Limits on Maturity Structure

| Maturity Structure of Borrowing | | | | |
|--|--------------------|--------------------|---------------------------------------|-------------------------------|
| | Upper Limit | Lower Limit | Maximum for period to 30/09/20 | Actuals as at 30/09/20 |
| Under 12 months | 25% | 0% | 2.89% | 0.06% |
| 12 months and 24 months | 30% | 0% | 4.07% | 4.07% |
| 24 months and 5 years | 50% | 0% | 9.88% | 9.88% |
| 5 years and 10 years | 50% | 0% | 34.30% | 34.30% |
| 10 years and 20 years | 60% | 0% | 17.20% | 17.20% |
| 20 years and 30 years | 70% | 0% | 0.62% | 0.62% |
| 30 years and 40 years | 80% | 0% | 33.87% | 33.87% |
| 40 years and 50 years | 90% | 0% | 0.00% | 0.00% |
| 50 years and above | 90% | 0% | 0.00% | 0.00% |

- 9.5. The indicator shows that the upper limits for all maturity profiles have not been breached to 30 September 2020.

10. Loans Fund Review

- 10.1. During 2019/2020, the Council carried out a review of how it accounts for the repayment of its loans fund advances. By repaying the advances over a longer period and applying this change retrospectively, the Council will underspend against its loan charges budget over the next few years. These underspends can be taken to reserves and used to support the Council's budget strategies.
- 10.2. The implementation of the findings of the Loans Fund Review was approved by the Executive Committee on 24 June 2020.

11. Employee Implications

- 11.1. There are no employee implications.

12. Financial Implications

- 12.1. The current rate of interest receivable remains low.
- 12.2. 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.
- 12.3. The costs of borrowing for capital expenditure have been built into the long term Revenue Budget Strategy.

13. Climate Change, Sustainability and Environmental Implications

- 13.1. There are no implications for climate change or sustainability in terms of the information contained in this report.
- 13.2. There is also no requirement to carry out an environmental impact assessment in terms of the information contained within this report.

14. Other Implications

- 14.1. Section 7 of this report provides details of how investment risk is managed.

15. Equality Impact Assessment and Consultation Arrangements

- 15.1. 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.
- 15.2. 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)

9 December 2020

Link(s) to Council Values/Ambitions/Objectives

- ♦ Accountable, effective, efficient and transparent

Previous References

- ♦ Prudential Indicators, Treasury Management Strategy and Annual Investment Strategy 2020/2021, South Lanarkshire Council, 25 March 2020
- ♦ Treasury Management Activity – First Quarter Review, Finance and Corporate Resources Committee, 19 August 2020

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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Maturity of Deposits Placed 1 April 2020 - 30 September 2020

