

Report

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Report to:	Finance and Information Technology Resources Committee
Date of Meeting:	9 November 2010
Report by:	Chief Executive

Subject:	Treasury Management Activity – Mid Year Review
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1. Purpose of Report

1.1. The purpose of the report is to:-

- ◆ Provide a mid year review of Treasury Management Activity for 2010/11.

2. Recommendation(s)

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

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

3. Background

- 3.1. In response to the events in 2008 and the difficulties faced by the banking sector, The Chartered Institute of Public Finance and Accountancy (CIPFA) revised the Code of Practice for Treasury Management in the Public Services (TM Code).
- 3.2. The Code of Practice for Treasury Management in the Public Services was adopted at the Finance and Information Technology Resources Committee (Special) on 11 February 2010.
- 3.3. Finance and Information Technology Resources Committee is responsible for ensuring effective scrutiny of the treasury management strategy and policies. However, in order to meet the requirements of the TM Code it was agreed that Executive Committee would receive reports on the Council's treasury management policies, practices and activities, including as a minimum, an annual strategy and plan in advance of the year, a mid year review and an annual report after financial year end. This report, therefore, will also be submitted to the Executive Committee for its information.
- 3.4. In order to provide members with information on the Councils' Treasury activities, a quarterly report to this committee has in the past been provided. This report concentrated mainly on investment activity, but did touch on other aspects of Treasury Management activity.

3.5. From this meeting onwards the quarterly investment activity reports submitted to Finance and Information Technology Resources Committee will be replaced by a fuller and more comprehensive Treasury Management Activity Report which will include borrowing and debt management information, and updates on Treasury Indicators, along side the regular reporting on investments, market performance, cash flow and risk management. Treasury Management Activity Reports will continue to be submitted on a quarterly basis but will also satisfy the reporting requirements under the revised TM Code.

4. Market Performance

4.1. The UK Base Rate remains at the historically low level of 0.5% and the Bank of England Asset Purchase Programme (commonly referred to as its policy of quantitative easing) remains at £200bn.

4.2. The Council's Treasury Management Advisers predict no change in the UK base rate until the second quarter of 2011.

4.3. Interest rates for the rest of 2010/11 are therefore expected to remain at a relatively low rate compared to previous years.

5. Debt Management and Borrowing Strategy

5.1. The Council began the year with debt of £606.295m with fixed rate loans from the Public Works Loans Board (PWLB) making up 90.90% of the debt. Fixed rate loans help to build in certainty to the calculation of future loan charges which forms a significant element of the Council's long term revenue budget strategy.

5.2. During 2009/10, no long term borrowing was taken to fund capital expenditure or maturing debt. Reserve balances were used in lieu of borrowing, reducing deposit levels and counterparty risk. This policy continued into 2010/11, however reserves are not infinite and so short term borrowing has been taken from the market at historically low rates in order to meet cash flow requirements and maintain liquidity.

5.3. Using reserves and borrowing short term cannot continue indefinitely. Longer term borrowing rates began to fall during the first half of 2010/11 to levels that were considered attractive and £202m of borrowing was taken to fund capital expenditure. Table 1 shows borrowing taken to 30 September 2010.

Table 1 – Borrowing taken to 30 September 2010.

	Balance as at 01/04/2010 £m	New Borrowing £m	Debt Maturing £m	Debt Repaid £m	Balance as at 30/09/2010 £m	Increase/Decrease in Borrowing £m
Short Term Borrowing	41.880	150.625	183.050	0.000	9.455	-32.425
Long Term Borrowing	564.415	195.515	0.000	0.000	759.930	195.515
TOTAL BORROWING	606.295	346.140	183.050	0.000	769.385	163.090

- 5.4. New borrowing taken during the first half of the financial year 2010/11 totalled £346.140m, of which £144.140m was short term borrowing in order to meet cash flow requirements and to maintain liquidity, at a weighted average interest rate of 0.39%. The vast majority (£136.640m) of this borrowing was from other local authorities.
- 5.5. The remaining £202.000m was borrowed from the PWLB in order to fund capital expenditure or maturing debt. Table 2 below shows the borrowing that was taken from the PWLB along with the average interest rate over the first half of 2010/11 for the relevant period. Maturity loans are loans where the full value of the loan is repayable at the end of the loan. EIP(Equal Instalment of Principal) loans require a portion of the loan to be repaid every year until the end of the loan term.

Table 2

Date	Principal £m	Type	Interest Rate	Period (Years)	Average Interest Rate for Period
29/04/2010	£11.000	Fixed Maturity	3.30%	6	2.68%
29/04/2010	£11.000	Fixed EIP	2.93%	9½	2.34%
10/05/2010	£10.000	Fixed Maturity	3.08%	6	2.68%
10/05/2010	£10.000	Fixed EIP	2.72%	9½	2.34%
01/09/2010	£20.000	Fixed Maturity	2.17%	6	2.68%
01/09/2010	£20.000	Fixed EIP	1.87%	9½	2.34%
01/09/2010	£20.000	Fixed EIP	1.87%	9½	2.34%
01/09/2010	£20.000	Fixed Maturity	2.18%	6	2.68%
10/09/2010	£15.000	Fixed EIP	1.83%	9	2.24%
10/09/2010	£15.000	Fixed Maturity	2.23%	6	2.68%
13/09/2010	£25.000	Fixed EIP	1.91%	9	2.24%
13/09/2010	£25.000	Fixed Maturity	1.99%	5	2.34%
Total	£202.000	Weighted Average	2.21%		

- 5.6. Due to the nature of EIP loans, £6.485m of this borrowing will be repaid in 2010/11 and has been included as short term borrowing in 5.3.
- 5.7. Any further borrowing required during 2010/11 to fund capital expenditure or maturing debt will be considered by The Executive Director (Finance and Information Technology Resources) who, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time.

6. Investment Activity

- 6.1. On a daily basis, the Treasury Management section within Finance and Information Technology 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. On 1 April 2010, Scottish Ministers introduced regulations on local authority investments. These regulations give greater freedom over their investments and subsequently an Annual Investment Strategy was presented to this Committee on 23 June 2010 which detailed permitted investment options for this Council.

- 6.3. The Council undertakes significant scrutiny of any counterparty that we place money with in partnership with our Treasury Advisers. 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 deposit would the deposit go ahead.
- 6.4. Despite the greater freedom over what the Council can invest in following the approval of the Annual Investment Strategy on 23 June 2010, no new investment types have been used to date.
- 6.5. Deposits made in the period 1 April 2010 to 30 September 2010 totalled £743.586m. This is broken down per sector and institution in Table 3 below. 57.61% of these deposits were made in the UK Government through the Debt Management Office (DMO) deposit facility. The DMO is the most secure counterparty, however rates of interest paid by the DMO are the lowest of all counterparties.

Table 3

Counterparty	Deposit Totals (£m)	% of Total Deposits	Average Interest Rate
Deposits in UK Government	428.351	57.61%	0.250%
Deposits in UK Local Authorities	151.430	20.36%	0.300%
Deposits in UK Banks:			
Royal Bank of Scotland	57.995		
Bank of Scotland	17.460		
Barclays Bank	24.250		
Total Deposits in UK Banks	99.705	13.41%	0.753%
Deposits in UK Building Societies:			
Nationwide	20.000		
Total Deposits in UK Building Societies:	20.000	2.69%	0.415%
Deposits in UK Subsidiaries of Foreign Banks:			
Santander UK plc (Formerly Abbey)	24.100		
Clydesdale Bank	20.000		
Total Deposits in UK Subsidiaries of Foreign Banks	44.100	5.93%	0.781%
Total Deposits 01/04/10 to 30/09/2010	743.586	100%	

- 6.6. The average interest rates achieved from the deposits are shown in Table 3. As the base interest rate has sat at 0.5% since March 2009 interest rates achievable from deposits are considerably lower than in previous years.
- 6.7. Actual deposits at 30 September 2011 totalled £155.649m.

7. Management of Risk

- 7.1. The new TM Code introduced a new section on Managing Treasury Management Risks, placing Credit and Counterparty risk at the forefront of treasury risks. The Council previously had met the requirement of the new code, and continue to do so.
- 7.2. It is recognised that no Treasury Management activity is without risk, and practices are put in place in order to limit risk. In February 2010, the Treasury Management Strategy was approved which set minimum criteria for placing deposits with banks, building societies, local authorities and the Debt Management Office.
- 7.3. The Annual Investment Strategy approved in June 2010 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. All deposits placed have met the criteria agreed by this Committee.
- 7.4. Part of the criteria for counterparties is meeting minimum credit ratings with the three main rating agencies. The credit ratings of counterparties used from 1 April 2010 to 30 September 2010 are detailed below in Tables 4 to 6.

Table 4 – Fitch Ratings

Long Term Rating	Short Term Rating	Individual Rating	Support Rating	Deposits Totals	Percentage of Total Deposits
AAA				£579.781m	77.97%
AA-	F1+	B	1	£68.350m	9.19%
AA-	F1+	C	1	£37.460m	5.04%
AA-	F1+	C/D	1	£7.186m	0.97%
AA-	F1+	D/E	1	£50.809m	6.83%
Total				£743.586m	100.00%

Table 5 – Moody's Ratings

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
AAA		£579.781m	77.97%
Aa3	P-1	£143.805m	19.34%
A1	P-1	£20.000m	2.69%
Total		£743.586m	100.00%

Table 6 – Standard and Poor's Ratings

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
AAA		£579.781m	77.97%
AA	A-1+	£24.100m	3.24%
AA-	A-1+	£24.250m	3.26%
A+	A-1	£115.455m	15.53%
Total		£743.586m	100.00%

- 7.5. The tables show that 77.97% of deposits were made with AAA rated counterparties (UK Government DMO account and other local authorities). All deposits were in line with approved lending limits and credit rating criteria.

- 7.6. The counterparty at the foot of Table 4 with Individual rating D/E is the Royal Bank of Scotland. The rating was upgraded on 18 December 2009 from E, reflecting the need at the time for UK Government assistance, to D/E. The support rating of 1 shows the support the bank will continue to receive from the UK Government. It should be noted that on 15 July 2010, the individual rating for the Royal Bank of Scotland was again upgraded, moving to C/D from D/E.
- 7.7. The counterparties in Table 4 with individual ratings of B are Barclays Bank, Nationwide and Santander UK plc, a wholly owned subsidiary of the Spanish bank Banco Santander. The counterparties with individual rating C are Bank of Scotland and Clydesdale Bank.
- 7.8. On 1 June 2010 Fitch Ratings downgraded the sovereign rating of the Kingdom of Spain from AAA to AA+. At the time it was decided to temporarily suspend Santander UK plc from the Council's counterparty list until the full impact of the downgrading of Spain's sovereign rating could be fully assessed.
- 7.9. The downgrading of Spain has had no impact on the credit rating of Santander UK plc and they were reinstated to the Council's counterparty list on 9 September 2010.
- 7.10. The graph at Appendix 1 shows the duration of deposits made from 1 April 2010 to 30 September 2010. The graph shows that since 1 April 2010 all deposits have been made for three months or less. The maximum maturity period was 91 days for deposits of £5m to two UK local authorities.
- 7.11. Deposits with Royal Bank of Scotland, Bank of Scotland and Santander UK plc are in instant access call accounts, each with a limit of £10m. Deposits with Clydesdale Bank are in a 15 day notice account. Notice is given when depositing funds with Clydesdale Bank to reduce any exposure to counterparty risk. As these accounts pay the highest interest rate available, we endeavour to ensure that the use of these accounts is maximised in the first instance, where possible.

8. Projected Cash Flow

- 8.1. The Council's cash flow reflects the day to day cash position experienced. The daily cash position is dependant on income received and expenditure made on any given day.
- 8.2. Projected cash flow for the quarter 1 October 2010 to 31 December 2010 is detailed graphically in Appendix 2 to this report. The graph shows a daily cash flow position showing the daily cash position moving between positive and negative balances.
- 8.3. The cumulative cash flow line shows a decrease of £71.005m in cash balances is expected over the three month period. This reflects the Council spending more money than we receive in income, however it should be noted that the expenditure includes capital spend which requires to be funded through borrowing. The cash flow projection does not include any funds that may be borrowed in the future.

9. Next Quarter Investment plans

- 9.1. It is proposed that the current investment framework is 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 and their access to the UK Government's Credit Guarantee Scheme is continued. Deposits will also continue to be placed with the DMO and UK local authorities.

- 9.2. We will continue to work with our Treasury Advisers, Arlingclose, to ensure we gain all information available on counterparties before any deposits are made.
- 9.3. As mentioned at 6.2. investment regulations now allow for a wider range of investments tools to be used. A paper proposing the use of Treasury Bills is being presented to this committee for approval.

10. Treasury Management Indicators

- 10.1. The revision to the Treasury Management Code has resulted in prudential indicators now becoming Treasury Management indicators.
- 10.2. 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.
- 10.3. **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 EIP borrowing to take full advantage of current interest rates.

	2010/11 Estimate	2010/11 Maximum for period to 30/09/10
	£m	£m
Upper limit of fixed rate exposures	180%	124%
Upper limit of variable rate exposures	30%	6.7%

The indicator shows that the upper limits have not been breached to 30/09/10.

- 10.3.1. 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 below:

Position as at 30 September 2010

	£m		£m
Total Debt	769.385		
Total Investments	(155.649)		
Total Net Debt	613.736		
Fixed Net Debt		Variable Net Debt	
Fixed Debt	760.499	Variable Debt	8.886
Fixed Investments	(0)	Variable Investments	(155.649)
Fixed Net Debt	760.499	Variable Net Debt	(146.763)
Exposure	124%	Exposure	(24%)
(Fixed Net Debt / Total Net debt)		(Variable Net Debt / Total Net debt)	

10.4. **Limits for External Debt** - The operational and authorised limits for external debt for the 2010/11 as per the Treasury Management Strategy Report 2010/11 are shown below, and include an estimate of £450m for the liability held in the balance sheet representing the PPP school assets. The table below shows the strategy figures, and the estimate excluding the PPP liability.

	2010/11	2010/11	2010/11	2010/11
	Estimate as per Strategy	Estimate excluding PPP Liability	Minimum Headroom to Limits in period	Headroom as at 30/09/10
	£m	£m	£m	£m
Operational Limit for external debt	1,270.000	820.000	5.08m	50.61m
Authorised Limit for external debt	1,290.000	840.000	25.08m	70.61m

10.5. The indicator shows that we have not breached the operational and authorised limits to 30/09/10. There has been a minimum level of headroom of £25.08m between actual and authorised level for external debt.

10.6. **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.

Maturity Structure of Fixed Rate Borrowings				
	Upper Limit	Lower Limit	Maximum for period to 30/09/10	Actuals as at 30/09/10
Under 12 months	10%	0%	2.33%	1.44%
12 months and 24 months	20%	0%	3.13%	2.33%
24 months and 5 years	50%	0%	8.14%	6.06%
5 years and 10 years	50%	0%	33.53%	33.35%
10 years and 20 years	60%	0%	6.89%	5.13%
20 years and 30 years	70%	0%	8.11%	6.04%
30 years and 40 years	80%	0%	1.10%	0.82%
40 years and 50 years	90%	0%	60.12%	44.81%
50 years and above	90%	0%	0%	0%

The indicator shows that the upper limits for all maturity profiles have not been breached to 30/09/10.

11. Employee Implications

11.1. There are no employee implications.

12. Financial Implications

12.1. The current rate of interest payable is very low in comparison to previous years. This is a direct result of the adherence of the Bank of England to a historically low base rate for the past four quarters.

12.2. Deposit interest received offsets Loan Charges made to the Councils 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.

13. Other Implications

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

14. Equality Impact Assessment and Consultation Arrangements

14.1. 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.

14.2. There is no requirement to carry out consultation.

Archibald Strang
Chief Executive

12 October 2010

Link(s) to Council Values/Improvement Themes/Objectives

◆ Accountable, effective and efficient

Previous References

◆ Finance and Information Technology Resources Committee, 1 June 2010

List of Background Papers

◆ Treasury Management Strategy 2010/2011

Contact for Further Information

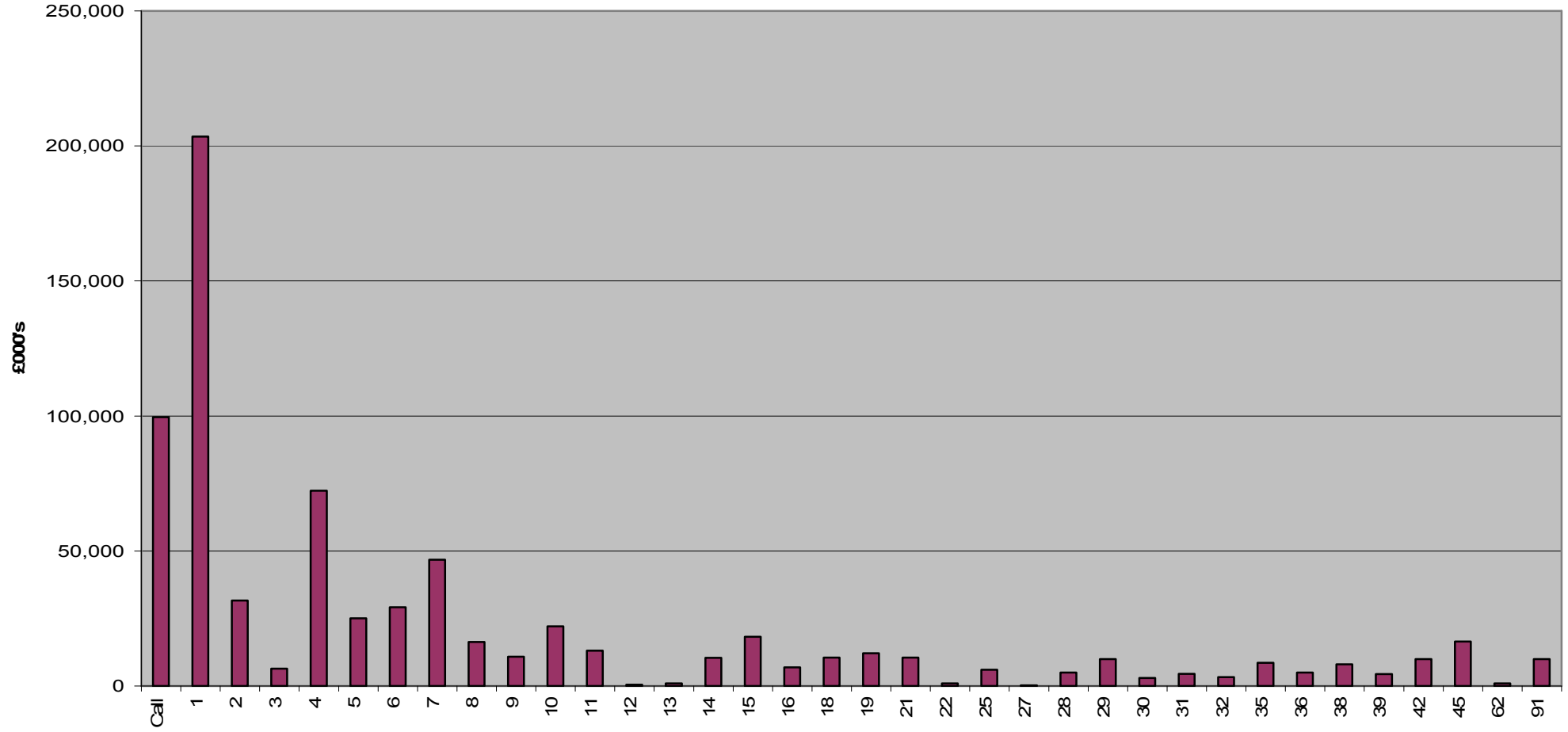
If you would like to inspect the background papers or want further information, please contact:-

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South Lanarkshire Council - Maturity of Deposits Placed 01/04/10 - 30/09/10



South Lanarkshire Council Cash Flow 01/10/10 - 31/12/10 Excluding Maturing Deposits

