

# Report

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Report to:	<b>Finance and Information Technology Resources Committee</b>
Date of Meeting:	<b>14 February 2012</b>
Report by:	<b>Executive Director (Finance and Corporate Resources)</b>

Subject:	<b>Treasury Management Activity – Third Quarter Review</b>
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## 1. Purpose of Report

1.1. The purpose of the report is to:-

- ◆ Provide a third quarter review of Treasury Management Activity for 2011/2012

## 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 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 2011 to 31 December 2011.

## 4. Market Performance

4.1. As at 31 December 2011, the UK Base Rate remained 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) remained at £200bn.

4.2. The Council's Treasury Management Advisers predict no change in the UK base rate during 2011/2012.

4.3. Interest rates for 2011/2012 are, therefore, expected to remain relatively low compared to previous years.

## 5. Debt Management and Borrowing Strategy

5.1. The Council began the year with debt of £760.132 million with fixed rate loans from the Public Works Loans Board (PWLB) making up 96.48% of the debt.

5.2. Table 1 below shows the movement in borrowing to 31 December 2011.

**Table 1 – Movement in Borrowing to 31 December 2011.**

	Balance as at 01/04/2011 £m	New Borrowing £m	Debt Maturing £m	Debt Repaid £m	Balance as at 31/12/2011 £m	Increase/Decrease in Borrowing £m
Short Term Borrowing	28.785	0.020	21.685	0.000	7.120	-21.665
Long Term Borrowing	731.347	80.000	0.000	0.000	811.347	80.000
<b>TOTAL BORROWING</b>	<b>760.132</b>	<b>80.020</b>	<b>21.685</b>	<b>0.000</b>	<b>818.467</b>	<b>58.335</b>

Note: New short term borrowing shown above of £0.020m comprises a new Group Life Assurance pay out received and held in trust by the Council for an employee's child. This is classed as borrowing for the Council.

5.3. New borrowing taken up to 31 December 2011 totalled £80.00m taken 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 to 31 December 2011 for the relevant period. Maturity loans are loans where the full value of the loan is repayable at the end of the loan.

**Table 2**

Date	Principal £m	Type	Interest Rate	Period (Years)	Average PWLB Rate 01/04/11 – 31/12/11
07/10/2011	£20.625	Fixed Maturity	2.84%	7½	3.38%
07/10/2011	£20.625	Fixed Maturity	3.03%	8½	3.60%
07/10/2011	£18.750	Fixed Maturity	3.20%	9½	3.79%
14/11/2011	£7.000	Fixed Maturity	2.99%	8½	3.60%
14/11/2011	£9.500	Fixed Maturity	3.17%	9½	3.79%
14/11/2011	£3.500	Fixed Maturity	3.32%	10½	3.96%
Total	£80.000	Weighted Average	3.05%		

5.4. Any further borrowing required during 2011/2012 to fund capital expenditure or maturing debt will be considered by the Executive Director (Finance and Corporate 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 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. 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 for 2011/2012 was presented to this

Committee on 10 February 2011 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 and details of negative rating watches. 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. 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 2011 to 31 December 2011 totalled £1,136.232m. This is broken down per sector and institution in Table 3 below. 65.19% 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 – Investment Activity 1 April 2011 – 31 December 2011**

<b>Counterparty</b>	<b>Deposit Totals (£m)</b>	<b>% of Total Deposits</b>	<b>Average Interest Rate</b>
<b>Deposits in UK Government</b>	<b>740.732</b>	<b>65.19%</b>	<b>0.250%</b>
<b>Deposits in UK Local Authorities</b>	<b>303.101</b>	<b>26.68%</b>	<b>0.371%</b>
<b>Deposits in Money Market Funds</b>	<b>41.649</b>	<b>3.67%</b>	<b>0.447%</b>
Deposits in UK Banks:			
Barclays	10.000		
Royal Bank of Scotland	40.750		
<b>Total Deposits in UK Banks</b>	<b>50.750</b>	<b>4.46%</b>	<b>0.763%</b>
<b>Total Deposits 01/04/10 to 31/12/2011</b>	<b>1,136.232</b>	<b>100%</b>	

- 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 as at 31 December 2011 totalled £146.649m.

## **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 2011, the Treasury Management Strategy was approved which set a framework for treasury management activities and limits on debt and investments in order to mitigate risks.
- 7.2. The Annual Investment Strategy, approved in February 2011, 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. Tables 4 to 6 show a breakdown of deposits with details of the credit ratings of banks and building societies used from 1 April 2011 to 31 December

2011. Deposits with the DMO are with the UK Government and so have a AAA rating. Deposits with local authorities are considered to be of very high credit quality despite most local authorities not having formal credit ratings.

**Table 4 – Fitch Ratings**

Long Term Rating	Short Term Rating	Individual Rating	Support Rating	Deposits Totals	Percentage of Total Deposits
Deposits in DMO (AAA)				£740.732m	65.19%
Deposits with Local Authorities				£303.101m	26.68%
AAAmf (Money Market Funds)				£41.649m	3.67%
AA-	F1+	B	1	£10.000m	0.88%
AA-	F1+	C	1	£20.500m	1.80%
AA-	F1+	C/D	1	£18.250m	1.61%
A	F1	C	1	£2.000m	0.17%
<b>Total</b>				<b>£1,136.232m</b>	<b>100.00%</b>

**Table 5 – Moody's Ratings**

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
Deposits in DMO (AAA)		£740.732m	65.19%
Deposits with Local Authorities		£303.101m	26.68%
Aaa/MR1+ (Money Market Funds)		£31.649m	2.79%
Aa3	P-1	£48.700m	4.28%
A2	P-1	£2.050m	0.18%
Money Market Fund Not Rated		£10.000	0.88%
<b>Total</b>		<b>£1,136.232m</b>	<b>100.00%</b>

**Table 6 – Standard and Poor's Ratings**

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
Deposits in DMO (AAA)		£740.732m	65.19%
Deposits with Local Authorities		£303.101m	26.68%
AAAm (Money Market Funds)		£41.649m	3.67%
AA-	A-1+	£10.000m	0.88%
A+	A-1	£40.500m	3.56%
A	A-1	£0.250m	0.02%
<b>Total</b>		<b>£1,136.232m</b>	<b>100.00%</b>

- 7.5. The tables show that 95.54% of deposits were made with counterparties of very high credit quality (UK Government DMO account, other local authorities and money market funds).
- 7.6. The remaining new deposits were placed with Barclays and on call with the Royal Bank of Scotland. The support rating of 1 shown in Table 4 indicates the strong support that the banks will continue to receive from the UK Government. Unchanged deposits remain in call accounts with Santander UK.
- 7.7. The graph at Appendix 1 shows the duration of deposits made from 1 April 2011 to 31 December 2011. The graph shows that, since 1 April 2011, the majority of

deposits have been made for three months or less. The maximum maturity period was 364 days for a deposit of £10.0m to Barclays.

- 7.8 Deposits with Santander UK plc are in an instant access call account, with a limit of £10m. As this account pays the highest interest rate available, we endeavour to ensure that the use of this account is maximised in the first instance, where possible, and as long as this bank meet our counterparty criteria.
- 7.9. On 25 May 2011, Moody's placed the long term ratings of a number of UK institutions on review for possible downgrade. This review has now concluded and downgrades to the ratings of Royal Bank of Scotland and Nationwide Building Society mean that these institutions no longer meet the Council's minimum lending criteria and have been removed from the Council's lending list. On 13 October 2011, the Council was notified that Fitch had downgraded Bank of Scotland and, as a result, this institution no longer met the Council's minimum lending criteria and has been removed from the Council's lending list.
- 7.10. Royal Bank of Scotland are the providers of banking services to the Council and, although they do not meet the minimum credit criteria for investments, will continue to be used for operational purposes.
- 7.11. Moody's and Fitch have stated that the downgrades did not reflect a deterioration in the financial strength of the banking system or that of the UK government, but their belief that the government was less likely in the future to provide support to institutions that got into difficulty.
- 7.12. On 16 December 2011, Fitch downgraded Barclays to a Long Term rating of A which no longer met the Council's minimum spending criteria. The Council has £10m with Barclays that matures on 6 July 2012. Due to contractual obligations, the deposit of £10m to Barclays cannot be withdrawn. No further deposits will be made after the existing deposit matures.
- 7.13. While the downgrades by the rating agencies mean that institutions do not currently meet our investment criteria, consideration will be given in the 2012/2013 investment strategy for how the rating agencies' decisions affect our approved limits.

## **8.0 Next Quarter Investment Plans**

- 8.1. The Annual Investment Strategy for 2011/2012 was approved by South Lanarkshire Council in February 2011.
- 8.2. 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. Deposits will also continue to be placed with the DMO and UK local authorities.
- 8.3. Deposits may also be placed with selected Money Market Funds that meet the Council's approved criteria.
- 8.4. Work is ongoing to arrange facilities that will allow the Council to buy Treasury Bills and it is anticipated that this will be complete in the next quarter.
- 8.4. 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. Treasury Management Indicators

9.1. The revisions to the Treasury Management Code have resulted in prudential indicators now becoming formally known as Treasury Management indicators.

9.2. 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.

**9.3. 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.

	2011/12	2011/12
	Estimate	Maximum for period to 31/11/12
	£m	%
Upper limit of fixed rate exposures	180%	126.54%
Upper limit of variable rate exposures	30%	-8.22%

The indicator shows that the upper limits have not been breached to 31 December 2011.

9.3.1. 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:

	£m		£m	
Total Debt	818.467			
Total Investments	(146.649)			
<b>Total Net Debt</b>	<b>671.818</b>			
<b>Fixed Net Debt</b>		<b>Variable Net Debt</b>		
Fixed Debt	791.708	Variable Debt	26.759	
Fixed Investments	(0.000)	Variable Investments	(146.649)	
<b>Fixed Net Debt</b>	<b>791.708</b>	<b>Variable Net Debt</b>	<b>(119.890)</b>	
<b>Exposure</b>	<b>117.85%</b>	<b>Exposure</b>	<b>-17.85%</b>	
(Fixed Net Debt / Total Net debt)		(Variable Net Debt / Total Net debt)		

**9.4. Limits for External Debt** - The operational and authorised limits for external debt for 2011/2012 as per the Treasury Management Strategy Report 2011/2012 are shown below and include an estimate of £269.640m 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.

	2011/12	2011/12	2011/12	2011/12
	Estimate as per Strategy	Estimate excluding PPP Liability	Minimum Headroom to Limits in period	Headroom as at 31/12/11
	£m	£m	£m	£m
Operational Limit for external debt	1,190.000	920.360	99.803m	101.893
Authorised Limit for external debt	1,210.000	940.360	119.803m	121.893

The indicator shows that we have not breached the operational and authorised limits to 31 December 2011. There has been a minimum level of headroom of £119.803m between actual and authorised level for external debt.

- 9.5. 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.

<b>Maturity Structure of Fixed Rate Borrowings</b>				
	<b>Upper Limit</b>	<b>Lower Limit</b>	<b>Maximum for period to 31/12/11</b>	<b>Actuals as at 31/12/11</b>
Under 12 months	10%	0%	3.90%	0.88%
12 months and 24 months	20%	0%	2.99%	2.70%
24 months and 5 years	50%	0%	17.09%	15.43%
5 years and 10 years	50%	0%	26.38%	26.38%
10 years and 20 years	60%	0%	5.41%	5.33%
20 years and 30 years	70%	0%	6.98%	6.30%
30 years and 40 years	80%	0%	0.00%	0.00%
40 years and 50 years	90%	0%	47.60%	42.98%
50 years and above	90%	0%	0%	0%

The indicator shows that the upper limits for all maturity profiles have not been breached to 31 December 2011.

## **10. Employee Implications**

- 10.1. There are no employee implications.

## **11. Financial Implications**

- 11.1. 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.
- 11.2. 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.
- 11.3. The costs of borrowing for capital expenditure have been built into the long term revenue budget strategy.

## **12. Other Implications**

12.1. There are no implications for sustainability in terms of the information contained in this report..

## **13. Risk Assessment**

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.

**Paul Manning**

**Executive Director (Finance and Corporate Resources)**

19 January 2012

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

- Accountable, effective and efficient

### **Previous References**

- Annual Investment Strategy 2011/12; Finance and Information Technology Resources Committee, 10 February 2011
- Treasury Management Strategy 2011/2012; Finance and Information Technology Resources Committee, 10 February 2011
- Treasury Management Activity – Mid Year Review; Finance and Information Technology Resources Committee, 22 November 2011

### **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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# South Lanarkshire Council - Maturity of Deposits Placed 01/04/11 - 31/12/11

