

Report

4

Report to:	Finance and Information Technology Resources Committee
Date of Meeting:	14 June 2011
Report by:	Chief Executive

Subject:	Treasury Management Activity – Fourth Quarter Review 2010/2011
----------	---

1. Purpose of Report

1.1. The purpose of the report is to:-

- ◆ Provide a fourth and final quarter review of Treasury Management Activity for 2010/2011.

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 to this Committee is provided. This report covers the period to 31 March 2011.

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 third quarter of 2011.

4.3. Interest rates for 2011/2012 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.

5.2. During 2009/2010 no long term borrowing was taken to fund capital expenditure or maturing debt with Reserve balances used in lieu of borrowing. The borrowing that was not taken was carried forward and included in the borrowing requirement for 2010/2011.

5.3. Table 1 below shows borrowing taken to 31 March 2011

Table 1 – Borrowing taken to 31 March 2011.

	Balance as at 01/04/2010 £m	New Borrowing £m	Debt Maturing £m	Debt Repaid £m	Balance as at 31/03/2011 £m	Increase/Decrease in Borrowing £m
Short Term Borrowing	41.880	150.641	192.357	0.000	0.164	-41.716
Long Term Borrowing	564.415	195.601	0.000	0.044	759.972	195.557
TOTAL BORROWING	606.295	346.242	192.357	0.044	760.136	153.841

5.4. 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.

5.5. New borrowing taken up to 31 March 2011 totalled £346.242m, 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.

5.6. £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 to 31 March 2011 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 PWLB Rate 01/04/10 – 31/3/11
29/04/2010	£11.000	Fixed Maturity	3.30%	6	3.12%
29/04/2010	£11.000	Fixed EIP	2.93%	9½	2.78%
10/05/2010	£10.000	Fixed Maturity	3.08%	6	3.12%
10/05/2010	£10.000	Fixed EIP	2.72%	9½	2.78%
01/09/2010	£20.000	Fixed Maturity	2.17%	6	3.12%
01/09/2010	£20.000	Fixed EIP	1.87%	9½	2.78%
01/09/2010	£20.000	Fixed EIP	1.87%	9½	2.78%
01/09/2010	£20.000	Fixed Maturity	2.18%	6	3.12%
10/09/2010	£15.000	Fixed EIP	1.83%	9	2.69%
10/09/2010	£15.000	Fixed Maturity	2.23%	6	3.12%
13/09/2010	£25.000	Fixed EIP	1.91%	9	2.69%
13/09/2010	£25.000	Fixed Maturity	1.99%	5	2.78%
Total	£202.000	Weighted Average	2.21%		

5.7. Due to the nature of EIP loans, £6.485m of this borrowing was repaid in 2010/11 and has been included as short term borrowing in Table 1.

5.8. Further borrowing to fund capital expenditure and maturing debt will be required in 2011/2012 and will be considered by the Chief Executive, 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. 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. 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.
- 6.3. 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 were used in 2010/2011. Preparations are being made to allow the use of new investment types and these will be used if appropriate.
- 6.4. Deposits made in the period 1 April 2010 to 31 March 2011 totalled £1,403.021m. This is broken down per sector and institution in Table 3 below. 44.76% 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	628.059	44.76%	0.250%
Deposits in UK Local Authorities	445.980	31.79%	0.430%
Deposits in UK Banks:			
Royal Bank of Scotland	99.272		
Bank of Scotland	177.460		
Barclays Bank	50.750		
Total Deposits in UK Banks	167.482	11.94%	0.735%
Deposits in UK Building Societies:			
Nationwide	47.400		
Total Deposits in UK Building Societies:	47.400	3.38%	0.486%
Deposits in UK Subsidiaries of Foreign Banks:			
Santander UK plc (Formerly Abbey)	24.100		
Clydesdale Bank	90.000		
Total Deposits in UK Subsidiaries of Foreign Banks	114.100	8.13%	0.767%
Total Deposits 01/04/10 to 31/03/2011	1,403.021	100%	

- 6.5. The average interest rates achieved from the deposits are shown in Table 3. As the base interest rate has remained at 0.5% since March 2009 interest rates achievable from deposits are considerably lower than in previous years.
- 6.6. Actual deposits as at 31 March 2011 totalled £114.407m.

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 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.
- 7.2. The Annual Investment Strategy, approved in June 2010, 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. All deposits placed have met the Strategy Criteria.
- 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 2010 to 31 March 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)				£628.059m	44.77%
Deposits with Local Authorities				£445.980m	31.79%
AA-	F1+	B	1	£122.250m	8.71%
AA-	F1+	C	1	£107.460m	7.66%
AA-	F1+	C/D	1	£48.463m	3.45%
AA-	F1+	D/E	1	£50.809m	3.62%
Total				£1,403.021m	100.00%

Table 5 – Moody's Ratings

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
Deposits in DMO (AAA)		£628.059m	44.77%
Deposits with Local Authorities		£445.980m	31.79%
Aa3	P-1	£238.982m	17.03%
A1	P-1	£90.000m	6.41%
Total		£1,403.021m	100.00%

Table 6 – Standard and Poor's Ratings

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
Deposits in DMO (AAA)		£628.059m	44.77%
Deposits with Local Authorities		£445.980m	31.79%
AA	A-1+	£34.100m	2.43%
AA-	A-1+	£40.750m	2.90%
A+	A-1	£254.132m	18.11%
Total		£1,403.021m	100.00%

- 7.5. The tables show that 76.56% of deposits were made with counterparties of very high credit quality (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 support rating of 1 shows the support the bank will continue to receive from the UK Government.
- 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. The graph at Appendix 1 shows the duration of deposits made from 1 April 2010 to 31 March 2011. The graph shows that, since 1 April 2010, the majority of deposits have been made for three months or less. The maximum maturity period was 278 days for a deposit of £5m to a Scottish local authority.
- 7.9. 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. 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. 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 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.
- 8.3. 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.

	2010/11 Estimate	2010/11 Maximum for period to 31/03/11
	£m	£m
Upper limit of fixed rate exposures	180%	125.9%
Upper limit of variable rate exposures	30%	6.7%

The indicator shows that the upper limits have not been breached to 31/03/11.

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	760.1				
Total Investments	(114.4)				
Total Net Debt	645.7				
Fixed Net Debt			Variable Net Debt		
Fixed Debt	751.3		Variable Debt	8.8	
Fixed Investments	(0)		Variable Investments	(114.4)	
Fixed Net Debt	751.3		Variable Net Debt	(105.6)	
Exposure	116%		Exposure	(16%)	
(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 the 2010/2011 as per the Treasury Management Strategy Report 2010/2011 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 31/03/11
	£m	£m	£m	£m
Operational Limit for external debt	1,270.000	820.000	5.08m	59.86m
Authorised Limit for external debt	1,290.000	840.000	25.08m	79.86m

The indicator shows that we have not breached the operational and authorised limits to 31/03/11. There has been a minimum level of headroom of £25.08m between actual and authorised level for external debt.

The minimum limits to the operational and authorised limits were due to overlapping loans for a period of six days while short term borrowing was replaced by long term borrowing.

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.

Maturity Structure of Fixed Rate Borrowings				
	Upper Limit	Lower Limit	Maximum for period to 31/03/11	Actuals as at 31/03/11
Under 12 months	10%	0%	2.33%	0.72%
12 months and 24 months	20%	0%	3.81%	3.81%
24 months and 5 years	50%	0%	10.48%	10.48%
5 years and 10 years	50%	0%	28.22%	28.22%
10 years and 20 years	60%	0%	6.89%	5.20%

20 years and 30 years	70%	0%	8.11%	6.12%
30 years and 40 years	80%	0%	1.10%	0.83%
40 years and 50 years	90%	0%	60.12%	45.35%
50 years and above	90%	0%	0%	0%

The indicator shows that the upper limits for all maturity profiles have not been breached to 31/03/11.

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.

11.2. 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.

11.3. 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.

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.

Archibald Strang
Chief Executive

17 May 2011

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

- ◆ Accountable, effective and efficient

Previous References

- ◆ Annual Investment Strategy 2010-11; Finance and Information Technology Resources Committee, 1 June 2010
- ◆ Treasury Management Strategy 2010/2011; Finance and Information Technology Resources Committee, 11 February 2010
- ◆ Treasury Management Activity – Third Quarter Review; Finance and Information Technology Resources Committee, 29 March 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:-
Paul Manning, Head of Finance
Ext: 4532 (Tel: 01698 454532)
E-mail: paul.manning@southlanarkshire.gov.uk

South Lanarkshire Council - Maturity of Deposits Placed 01/04/10 - 31/03/11

