

Report

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Report to:	Finance and Information Technology Resources Committee
Date of Meeting:	29 March 2011
Report by:	Chief Executive

Subject:	Treasury Management Activity - Third Quarter Review
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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 2010/11.

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 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. In order to meet the requirements of the TM Code, it was agreed that the 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.
- 3.4. The Finance and Information Technology Resources Committee is responsible for ensuring effective scrutiny of the treasury management strategy and policies.
- 3.5. In order to provide Committee with information on the Council's 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.
- 3.6. At the meeting of this Committee on 9 November 2010, a Treasury Management Mid Year Review was submitted that including borrowing and debt management information, and updates on Treasury Indicators, alongside the regular reporting on investments, market performance, cash flow and risk management. It was agreed that future quarterly reports to this Committee would be prepared on that basis.

This is the first of the quarterly reports in the revised format and satisfies 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 third quarter of 2011.
- 4.3. Interest rates for the rest of 2010/11 and 2011/12 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 2009/10, no long term borrowing was taken to fund capital expenditure or maturing debt. Reserve balances were used in lieu of borrowing.
- 5.3. 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.
- 5.4. New borrowing taken up to 31 December 2010 totalled £346.143m, 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. £0.003m was borrowed from the Scottish Veterans Garden Association who have deposited £0.019m with South Lanarkshire Council in order to ensure that their funds attract interest. The interest rate on their deposit is 4.825%.
- 5.6. Table 1 below shows borrowing taken to 31 December 2010

Table 1 – Borrowing taken to 31 December 2010.

	Balance as at 01/04/2010 £m	New Borrowing £m	Debt Maturing £m	Debt Repaid £m	Balance as at 31/12/2010 £m	Increase/Decrease in Borrowing £m
Short Term Borrowing	41.880	150.628	186.806	0.000	5.702	-36.178
Long Term Borrowing	564.415	195.515	0.000	0.000	759.930	195.515
Total Borrowing	606.295	346.143	186.806	0.000	765.632	159.337

- 5.7. £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 December 2010 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 – 31/12/10
29/04/2010	£11.000	Fixed Maturity	3.30%	6	2.84%
29/04/2010	£11.000	Fixed EIP	2.93%	9½	2.50%
10/05/2010	£10.000	Fixed Maturity	3.08%	6	2.84%
10/05/2010	£10.000	Fixed EIP	2.72%	9½	2.50%
01/09/2010	£20.000	Fixed Maturity	2.17%	6	2.84%
01/09/2010	£20.000	Fixed EIP	1.87%	9½	2.50%
01/09/2010	£20.000	Fixed EIP	1.87%	9½	2.50%
01/09/2010	£20.000	Fixed Maturity	2.18%	6	2.84%
10/09/2010	£15.000	Fixed EIP	1.83%	9	2.41%
10/09/2010	£15.000	Fixed Maturity	2.23%	6	2.84%
13/09/2010	£25.000	Fixed EIP	1.91%	9	2.41%
13/09/2010	£25.000	Fixed Maturity	1.99%	5	2.50%
Total	£202.000	Weighted Average	2.21%		

5.8. 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 Table 1.

5.9. Any further borrowing required during 2010/11 to fund capital expenditure or maturing debt 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. 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. 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 31 December 2010 totalled £1,055.866m. This is broken down per sector and institution in Table 3 below. 50.64% 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	534.684	50.64%	0.250%
Deposits in UK Local Authorities	275.280	26.07%	0.371%
Deposits in UK Banks:			
Royal Bank of Scotland	76.192		
Bank of Scotland	17.460		
Barclays Bank	40.750		
Total Deposits in UK Banks	134.402	12.73%	0.737%
Deposits in UK Building Societies:			
Nationwide	27.400		
Total Deposits in UK Building Societies:	27.400	2.60%	0.437%
Deposits in UK Subsidiaries of Foreign Banks:			
Santander UK plc (Formerly Abbey)	24.100		
Clydesdale Bank	60.000		
Total Deposits in UK Subsidiaries of Foreign Banks	84.100	7.96%	0.770%
Total Deposits 01/04/10 to 30/09/2010	1,055.866	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 as at 31 December 2010 totalled £112.400m. Deposits as at 31 March 2010 were recorded in the Annual Accounts at £16.112m.

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. South Lanarkshire Council continues to meet the requirements of the TM Code.

- 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. 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 December 2010. Deposits with the DMO are with the UK Government and so have an 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)				£534.684m	50.64%
Deposits with Local Authorities				£275.280m	26.07%
AA-	F1+	B	1	£92.250m	8.74%
AA-	F1+	C	1	£77.460m	7.34%
AA-	F1+	C/D	1	£25.383m	2.40%
AA-	F1+	D/E	1	£50.809m	4.81%
Total				£1,055.866m	100.00%

Table 5 – Moody's Ratings

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
Deposits in DMO (AAA)		£534.684m	50.64%
Deposits with Local Authorities		£275.280m	26.07%
Aa3	P-1	£185.902m	17.61%
A1	P-1	£60.000m	5.68%
Total		£1,055.866m	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)		£534.684m	50.64%
Deposits with Local Authorities		£275.280m	26.07%
AA	A-1+	£24.100m	2.28%
AA-	A-1+	£40.750m	3.86%
A+	A-1	£181.052m	17.15%
Total		£1,055.866m	100.00%

- 7.5. The tables show that 76.71% 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 show 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 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, the majority of deposits have been made for three months or less. The maximum maturity period was 95 days for a deposit of £2.6m to a UK local authority.
- 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. 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.
- 7.12. On 17 February 2011, Clydesdale Bank's long term rating was placed on negative rating watch by Moody's. Clydesdale Bank has been suspended from the Council's counterparty list until the outcome of the review is known. All deposits with Clydesdale Bank referred to in this report were made prior to the negative rating watch. The Council currently has no deposits with Clydesdale Bank.

8. Projected Cash Flow

- 8.1. 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.
- 8.2. Projected cash flow for the quarter 1 March 2011 to 31 May 2011 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 £66.801m 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.

10. Treasury Management Indicators

- 10.1. The revisions to the Treasury Management Code have resulted in prudential indicators now becoming formally known as 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	2010/11
	Estimate	Maximum for period to 31/12/10
	£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 31/12/10.

- 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:

	£m		£m
Total Debt	765.6		
Total Investments	(112.4)		
Total Net Debt	653.2		
Fixed Net Debt		Variable Net Debt	
Fixed Debt	756.7	Variable Debt	8.9
Fixed Investments	(0)	Variable Investments	(112.4)
Fixed Net Debt	756.7	Variable Net Debt	(103.5)
Exposure	116%	Exposure	(16%)
(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 31/12/10
	£m	£m	£m	£m
Operational Limit for external debt	1,270.000	820.000	5.08m	54.37m
Authorised Limit for external debt	1,290.000	840.000	25.08m	74.37m

The indicator shows that we have not breached the operational and authorised limits to 31/12/10. 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.

- 10.5. **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 31/12/10	Actual as at 31/12/10
Under 12 months	10%	0%	2.33%	0.72%
12 months and 24 months	20%	0%	3.78%	3.78%
24 months and 5 years	50%	0%	10.40%	10.40%
5 years and 10 years	50%	0%	28.01%	28.01%
10 years and 20 years	60%	0%	6.89%	5.16%
20 years and 30 years	70%	0%	8.11%	6.07%
30 years and 40 years	80%	0%	1.10%	0.82%
40 years and 50 years	90%	0%	60.12%	45.04%
50 years and above	90%	0%	0%	0%

The indicator shows that the upper limits for all maturity profiles have not been breached to 31/12/10.

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 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.

12.3. The costs of borrowing for capital expenditure have been built into the long term revenue budget strategy.

13. Other Implications

13.1. 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.

13.2. There is no requirement to undertake any consultation in terms of the content of this report.

Archibald Strang
Chief Executive

2 March 2011

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

◆ Value: Accountable, Effective and Efficient

Previous References

- ◆ Annual Investment Strategy 2010-11; Finance and Information Technology Resources Committee, 1 June 2010
- ◆ Treasury Management Investment Activity – Quarterly Report; Finance and Information Technology Resources Committee, 1 June 2010
- ◆ Treasury Management Activity – Mid Year Review; Finance and Information Technology Resources Committee, 9 November 2010
- ◆ Treasury Management Strategy 2010/2011; Finance and Information Technology Resources Committee, 11 February 2010

List of Background Papers

None

Contact for Further Information

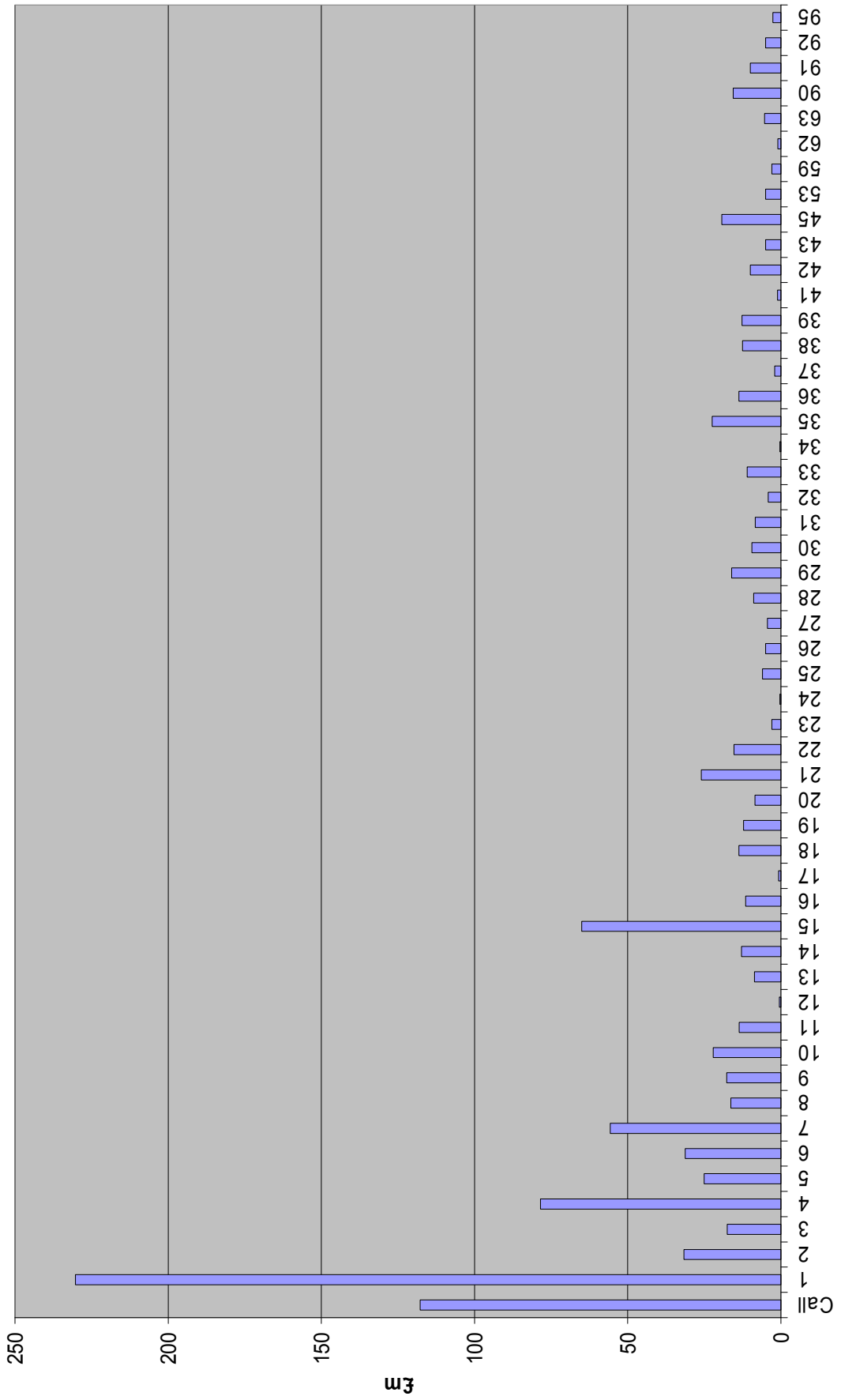
If you would like to inspect the background papers or want further information, please contact:-

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South Lanarkshire Council - Maturity of Deposits Placed 01/04/10 - 31/12/10



South Lanarkshire Cash Flow 01/03/11 - 31/05/11 Excluding Maturing Deposits

