Agenda Item

Report

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Report to:	**Finance and Corporate Resources Committee**
Date of Meeting:	**7 February 2018**
Report by:	**Executive Director (Finance and Corporate Resources)**

Subject:	**Treasury Management Activity – Third Quarter Review**

1. Purpose of Report

1.1. The purpose of the report is to:-

- provide a third quarter review of Treasury Management Activity for 2017/2018

2. Recommendation(s)

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

(1) that the contents of the 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 to 31 December 2017.

4. Market Performance

4.1. As at 31 December 2017, the UK Base Rate was at 0.50% and the Bank of England Asset Purchase Programme (commonly referred to as its policy of quantitative easing) remained at £435bn.

5. Debt Management and Borrowing Strategy

5.1. The Council began the year with debt of £928.489m with fixed rate loans from the Public Works Loans Board (PWLB) making up 98.94% of the debt.

5.2. Table 1 overleaf shows the movement in borrowing to 31 December 2017. 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 31 December 2017

	Balance as at 01/04/2017 £m	New Borrowing £m	Debt Maturing £m	Debt Repaid £m	Balance as at 31/12/2017 £m	Increase/ Decrease in Borrowing £m
Short Term Borrowing	24.325	0.00	(14.402)	0.00	9.923	(14.402)
Long Term Borrowing	904.164	0.00	0.00	0.00	904.164	0.00
TOTAL BORROWING	928.489	0.00	(14.402)	0.00	914.087	(14.402)

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 £161.943m during 2017/2018.

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 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 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 Prudential Indicators, Treasury Management Strategy and Annual Investment Strategy Report for 2017/2018 was presented to South Lanarkshire Council (Special) on 16 February 2017 detailing permitted investments for this Council.

6.3. The Council undertakes significant scrutiny of any counterparty that we place money with in partnership with our Treasury 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 to 31 December 2017 totalled £856.867m. This is the cumulative deposits placed over this period. This is broken down per sector and institution in Table 2 below. 73.03% of these deposits were made in the UK Government through the Debt Management Office (DMO) deposit facility (69.16%) and Treasury-Bills (3.87%).

6.5. Local authorities borrow from other local authorities for short term cash flow reasons. This would appear as a deposit for South Lanarkshire Council when another council has borrowed from us. This accounts for 22.75% of deposits with the remaining 4.22% 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 2 – Investment Activity 1 April 2017 to 31 December 2017

Counterparty	Deposit Totals (£m)	% of Total Deposits	Average Interest Rate
Deposits in UK Government			
Debt Management Account Deposit Facility	592.590	69.16%	0.12%
Treasury-Bills	33.195	3.87%	0.21%
Total Deposits in UK Government	**625.785**	**73.03%**	**0.12%**
Deposits in UK Local Authorities	**194.950**	**22.75%**	**0.23%**
Deposits in UK Banks and Building Societies:			
Bank of Scotland	36.132	4.22%	0.17%
Total Deposits in UK Banks and Building Societies	**36.132**	**4.22%**	**0.17%**
Total Deposits 01/04/2017 to 31/12/2017	**856.867**	**100.00%**	**0.15%**

6.7. The average interest rates achieved from the deposits are also shown in Table 2 above. As the base rate has been at, or below, 0.5% since March 2009, interest rates achievable from deposits remain low with the average rates on all deposits sitting at 0.15%

6.8. Actual deposits as at 31 December 2017 totalled £85.259m.

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 2017, the Treasury Management Strategy was approved which set a framework for Treasury Management activities in 2017/2018 and limits on debt and investments in order to mitigate risks.

7.2. The Annual Investment Strategy for 2017/2018, approved in February 2017, 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 3 to 5 show a breakdown of deposits with details of the credit ratings of banks and building societies used from 1 April to 31 December 2017. 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 3 – Fitch Ratings

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
Deposits with UK Government (AA)		625.785m	73.03%
Deposits with Local Authorities		194.950m	22.75%
A+	F1	36.132m	4.22%
Total		**856.867m**	**100.00%**

Table 4 – Moody's Ratings

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
Deposits with UK Government (Aa1)/(Aa2)		625.785m	73.03%
Deposits with Local Authorities		194.950m	22.75%
Aa3	P-1	16.930m	1.98%
A1	P-1	19.202m	2.24%
Total		**856.867m**	**100.00%**

Table 5 – Standard and Poor's Ratings

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
Deposits with UK Government (AA)		625.785m	73.03%
Deposits with Local Authorities		194.950m	22.75%
A	A-1	36.132m	4.22%
Total		**856.867m**	**100.00%**

7.5. The tables above show that 95.78% of deposits were made with counterparties of very high credit quality (UK Government DMO account, T-Bills 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 to 31 December 2017. The graph shows that, since 1 April 2017, all deposits have been made for 1 year or less. The maximum maturity period of 91 days was for a deposit of £2m with Moray Council.

8. Next Quarter Investment Plans

8.1. On 3 January 2018, the Markets in Financial Instruments Directive (MiFID II), came into effect. This is the EU legislation that regulates firms who provide services to clients linked to "financial instruments".

8.2. As a result of this, the Council has been reclassified from a professional client to a retail client.

8.3. While MiFID II does not apply to the majority of the Council's investment activity such as fixed term deposits with the DMO, other local authorities or deposits in the Bank of Scotland call account, money market brokers used by the Council to arrange deposits with local authorities have informed the Council that they will not be able to carry out business with retail clients.

8.4. This is due to the additional work that brokers are required to carry out when dealing with retail clients. For example, a broker is required to undertake checks to ensure that a product is suitable for a retail client, but can assume that a professional client has the necessary level of experience, knowledge and expertise to understand the risks involved in a transaction.

8.5. Local authorities have the option of being treated as 'elective professional', provided they can meet a set of qualitative and quantitative criteria. This means that the Council would be able to continue to use money market brokers to arrange deposits with other local authorities.

8.6. Staff within Finance Services are working with the brokers concerned to complete the necessary paperwork to elect up to professional status. This does not increase the risk to the Council, but merely allows the current approach to investments to be maintained.

8.7. 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.

8.8. Treasury Bills will be used when they return a higher yield than deposits in the DMO for the same, very low risk.

8.9. Deposits may also be placed with selected Money Market Funds that meet the Council's approved criteria.

8.10. We will continue to work with our Treasury Advisers 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 below.

9.2. **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 Equal Instalment of Principal (EIP) borrowing to take full advantage of current interest rates. This is shown in Table 6 overleaf.

Table 6 – Limits on Fixed/Variable Rate Exposure

	Indicator	**Maximum during period 01/04/17 to 31/12/17**
Upper limit of fixed rate exposures	180%	112.69%
Upper limit of variable rate exposures	30%	0.75%

9.3. The indicator shows that the upper limits have not been breached during the period from 1 April to 31 December 2017.

9.4. 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 in Table 7 below using figures for debt and investments as at 31 December 2017.

Table 7 – Calculation of Fixed/Variable Rate Exposure as at 31 December 2017

	£m		**£m**
Total Debt	914.087		
Less Total Investments	(85.259)		
= Total Net Debt	**828.828**		
Fixed Net Debt		**Variable Net Debt**	
Fixed Debt	904.587	Variable Debt	9.500
Less Fixed Investments	(0.000)	Less Variable Investments	(85.259)
= Fixed Net Debt	**904.587**	**= Variable Net Debt**	**(75.759)**
Exposure	**109.14%**	**Exposure**	**(9.14%)**
(Fixed Net Debt / Total Net debt)		(Variable Net Debt / Total Net debt)	

9.5. **Limits for External Debt -** The operational and authorised limits for external debt for 2017/2018 were set in the Prudential Indicators, Treasury Management Strategy and Annual Investment Strategy 2017/2018 approved by South Lanarkshire Council on 16 February 2017. These are shown in Table 8 below, along with a column showing the difference between the actual debt level and the limits (Headroom).

Table 8 – Limits for External Debt

	Estimate as per 2017/18 Strategy	Minimum Headroom to Limits in period	Headroom as at 31/12/17
	£m	£m	£m
Operational Limit for external debt	1,150.000	221.511	235.913
Authorised Limit for external debt	1,170.000	241.511	255.913

9.6. The indicator shows that we have not breached the operational and authorised limits to 31 December 2017. There has been a minimum level of headroom of £241.511m between actual and authorised limit for external debt.

9.7. **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. This is shown in Table 9 below.

Table 9 – Limits on Maturity Structure

Maturity Structure of Fixed Rate Borrowings				
	Upper Limit	Lower Limit	Maximum for period to 31/12/17	Actuals as at 31/12/17
Under 12 months	15%	0%	2.65%	1.10%
12 months and 24 months	20%	0%	2.47%	2.47%
24 months and 5 years	50%	0%	9.87%	9.87%
5 years and 10 years	50%	0%	13.02%	13.02%
10 years and 20 years	60%	0%	33.41%	33.41%
20 years and 30 years	70%	0%	2.46%	2.46%
30 years and 40 years	80%	0%	32.78%	32.78%
40 years and 50 years	90%	0%	4.89%	4.89%
50 years and above	90%	0%	0.00%	0.00%

9.8. The indicator shows that the upper limits for all maturity profiles have not been breached to 31 December 2017.

10. Provision of Banking Services

10.1. The Council currently has a contract for the provision of banking services with Royal Bank of Scotland plc that expires on 31 March 2018. This is an essential service for the Council and any disruption to this service would present a significant risk.

10.2. During 2017, a mini competition was ran under the Eastern Shires Purchasing Organisation (ESPO) national framework for Banking Services. As a result of this process, Royal Bank of Scotland plc were awarded the contract for banking services for the period 1 April 2018 to 31 March 2022.

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 mimimal, 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.

13.2. There are no implications in terms of sustainability.

13.3. There is no requirement to carry out an environmental impact assessment in terms of the information contained within this report.

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 any consultation in terms of the information provided in this report.

Paul Manning
Executive Director (Finance and Corporate Resources)

29 December 2017

Link(s) to Council Values/Ambitions/Objectives

- Accountable, effective, efficient and transparent

Previous References

- Prudential Indicators, Treasury Management Strategy and Annual Investment Strategy 2017/2018, South Lanarkshire Council - 16 February 2017
- Treasury Management Activity – First Quarter Review, Finance and Corporate Resources Committee - 6 September 2017
- Treasury Management Activity – Second Quarter Review, Finance and Corporate Resources Committee - 15 November 2017

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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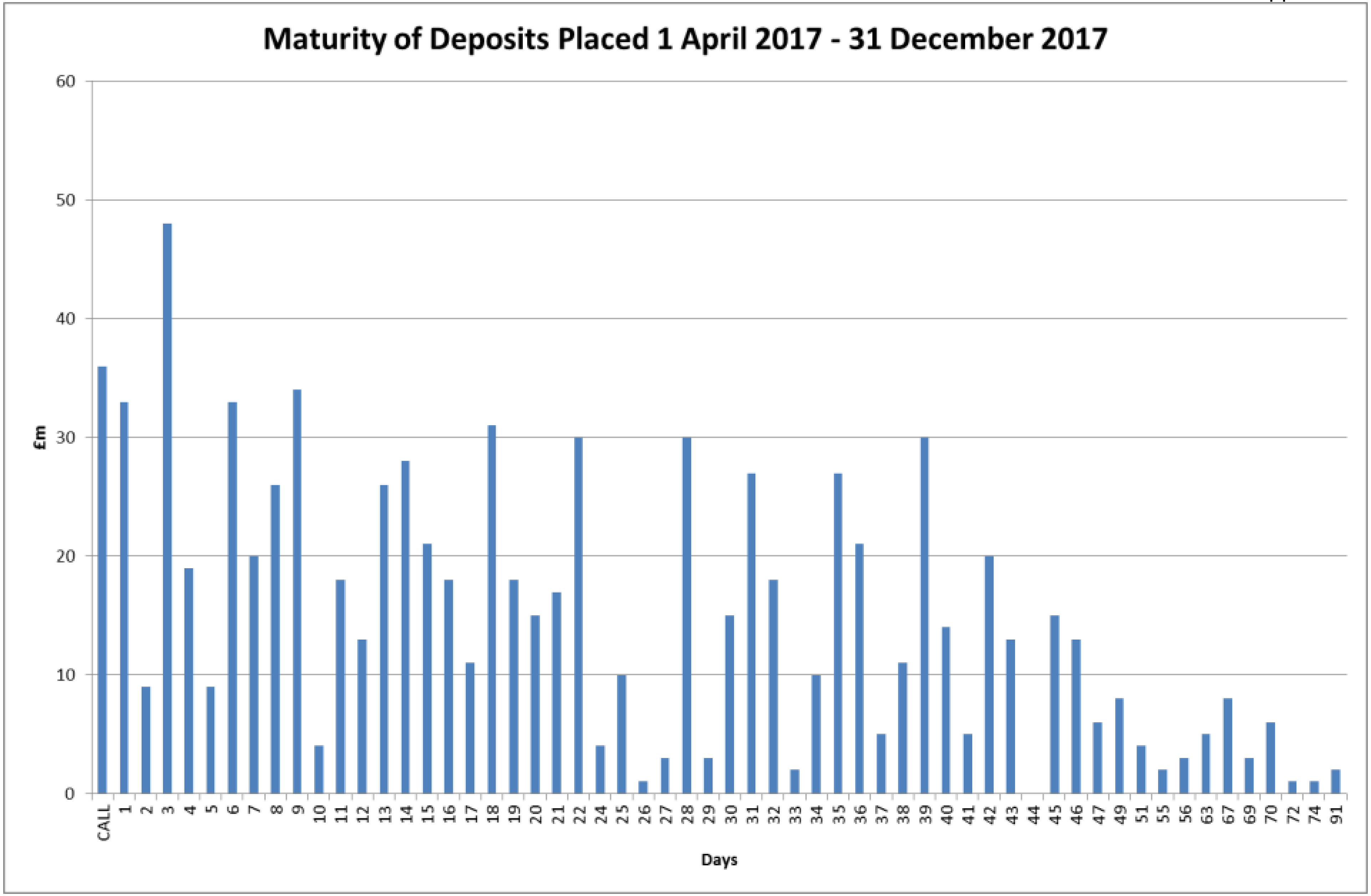
Appendix 1



Maturity of Deposits Placed 1 April 2017 - 31 December 2017
£m
60
50
40
30
20
10
0
Days
CALL 1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 24 25 26 27 28 29 30 31 32 33 34 35 36 37 38 39 40 41 42 43 44 45 46 47 49 51 55 56 63 67 69 70 72 74 91