

Report

13

Report to:	Finance and Information Technology Resources Committee
Date of Meeting:	13 September 2011
Report by:	Chief Executive

Subject:	Treasury Management Activity – First Quarter Review
----------	--

1. Purpose of Report

1.1. The purpose of the report is to:-

- ◆ provide a first 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 to this Committee will be provided. This report covers the period to 30 June 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 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 £760.132m with fixed rate loans from the Public Works Loans Board (PWLB) making up 96.48% of the debt.

5.2. 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. As at 30 June 2011, no further long term borrowing has been taken.

5.3. Table 1 below shows the movement in borrowing to 30 June 2011.

Table 1 – Movement in Borrowing to 30 June 2011.

	Balance as at 01/04/2011 £m	New Borrowing £m	Debt Maturing £m	Debt Repaid £m	Balance as at 30/06/2011 £m	Increase/Decrease in Borrowing £m
Short Term Borrowing	28.785	0.020	8.149	0.000	20.656	-8.129
Long Term Borrowing	731.347	0.000	0.000	0.000	731.347	0.000
TOTAL BORROWING	760.132	0.020	8.149	0.000	752.003	-8.129

Note : new 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.

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 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, 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 10 February 2011, no new investment types were used up to 30 June 2011. However, money market funds are now in place and will be considered for use from quarter 2.
- 6.5. Deposits made in the period 1 April 2011 to 30 June 2011 totalled £269.230m. This is broken down per sector and institution in Table 3 below. 68.56% 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 – 30 June 2011

Counterparty	Deposit Totals (£m)	% of Total Deposits	Average Interest Rate
Deposits in UK Government	184.580	68.56%	0.250%
Deposits in UK Local Authorities	66.400	24.66%	0.419%
Deposits in UK Banks:			
Royal Bank of Scotland	18.250		
Total Deposits in UK Banks	18.250	6.78%	0.750%
Total Deposits 01/04/11 to 30/06/2011	269.230	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 30 June 2011 totalled £110.241m.

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. All deposits placed have met the criteria agreed by this Committee.

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 30 June 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)				£184.580m	68.56%
Deposits with Local Authorities				£66.400m	24.66%
AA-	F1+	C/D	1	£18.250m	6.78%
Total				£269.230m	100.00%

Table 5 – Moody's Ratings

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
Deposits in DMO (AAA)		£184.580m	68.56%
Deposits with Local Authorities		£66.400m	24.66%
Aa3	P-1	£18.250m	6.78%
Total		£269.230m	100.00%

Table 6 – Standard and Poors Ratings

Long Term Rating	Short Term Rating	Deposits Totals	Percentage of Total Deposits
Deposits in DMO (AAA)		£184.580m	68.56%
Deposits with Local Authorities		£66.400m	24.66%
A+	A-1	£18.250m	6.78%
Total		£269.230m	100.00%

- 7.4. The tables show that 93.22% 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.
- 7.5. The remaining new deposits were placed on call with the Royal Bank of Scotland. The support rating of 1 shown in Table 4 indicates the strong support that the bank will continue to receive from the UK Government. Unchanged deposits remain in call accounts with Bank of Scotland and Santander UK.
- 7.6. The graph at Appendix 1 shows the duration of deposits made from 1 April 2011 to 30 June 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 98 days for a deposit of £2.2m to a UK local authority.
- 7.7. 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. Following the approval of a report by this Committee on 14 June 2011 Money Market Funds will be used for investments.

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 30/06/11
	£m	£m
Upper limit of fixed rate exposures	180%	117.11%
Upper limit of variable rate exposures	30%	-10.88%

The indicator shows that the upper limits have not been breached to 30/06/11.

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	752.003			
Total Investments	(110.241)			
Total Net Debt	641.761			
Fixed Net Debt		Variable Net Debt		
Fixed Debt	743.204	Variable Debt	8.799	
Fixed Investments	(0.000)	Variable Investments	(110.241)	
Fixed Net Debt	743.204	Variable Net Debt	(101.442)	
Exposure	115.81%	Exposure	(15.81%)	
(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 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	Estimate	Minimum	Headroom

	Strategy	excluding PPP Liability	Headroom to Limits in period	as at 30/06/11
	£m	£m	£m	£m
Operational Limit for external debt	1,190.000	920.360	160.208	168.358
Authorised Limit for external debt	1,210.000	940.360	180.208	188.358

The indicator shows that we have not breached the operational and authorised limits to 30/06/11. There has been a minimum level of headroom of £168.358m 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.

Maturity Structure of Fixed Rate Borrowings				
	Upper Limit	Lower Limit	Maximum for period to 30/06/11	Actuals as at 30/06/11
Under 12 months	10%	0%	3.81%	2.75%
12 months and 24 months	20%	0%	2.87%	2.87%
24 months and 5 years	50%	0%	18.53%	18.53%
5 years and 10 years	50%	0%	18.01%	18.01%
10 years and 20 years	60%	0%	5.27%	5.27%
20 years and 30 years	70%	0%	6.71%	6.71%
30 years and 40 years	80%	0%	0.07%	0.07%
40 years and 50 years	90%	0%	45.78%	45.78%
50 years and above	90%	0%	0%	0%

The indicator shows that the upper limits for all maturity profiles have not been breached to 30/06/11.

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. 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 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.

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.

Archibald Strang
Chief Executive

5 September 2011

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

◆ Accountable, effective and efficient

Previous References

◆ Finance and Information Technology Resources Committee, 10 February 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 01/04/11 - 30/06/11

