

The Highland Council

Resources Committee – 26 August 2015

Agenda Item	18(a)
Report No	RES/73/15

Treasury Management - Summary of Transactions

April, May and June 2015

Report by Director of Finance

Summary

This report on the treasury management transactions undertaken within the period is submitted to Committee in compliance with CIPFA's Code of Practice on Treasury Management and the Council's approved Financial Regulations.

1. Background

- 1.1 This report sets out treasury management transactions during the period, reflecting activity undertaken to manage the Council's cash flows, and borrowing to fund capital expenditure.
- 1.2 In managing the Council's long term borrowing requirement, the Finance Service will look to take external Public Works Loan Board (PWLB) borrowing at the most opportune time, to take advantage of the lowest interest rates available. The strategy for 2015/16 is to make the best use of the low rates available on temporary borrowing but will monitor long term borrowing rates.
- 1.3 During the period April to June 2015, the following long-term borrowing was undertaken from the PWLB in order to finance the National Housing Trusts (NHT).

Month	Amount	Purpose of borrowing	Duration	Rate
May 2015	£1.3m	NHT – Westercraigs	6.5 years	2.36%

- 1.4 In managing the Council's cash flow the Finance Service will also consider short-term borrowing opportunities, in order to meet the Council's short-term cash flow requirements. There was temporary borrowing of £31.3m undertaken in the period April to June 2015 and £14m of temporary loans were repaid during this period.
- 1.5 It should be noted that the average interest rate on deposits continues to be low due to the low rates on call accounts and money market funds, attributable to the current market environment.

- 1.6 When placing temporary deposits (lending) the Council uses a creditworthiness matrix provided by Capita Treasury Services Ltd to assess the risks involved in lending to individual counterparties. The Council's lending policy is constantly monitored in conjunction with the matrix. This affords a balance of operational flexibility and risk awareness in managing the Council's temporary investments.
- 1.7 Details of the Council's investment policy, the credit rating of these counterparties, and deposits held as at 30 June 15 are at Appendix 1.
- 1.8 The Council's Treasury Management Policy is regularly reviewed.

2. LOBOs (Lenders Option, Borrowers Option)

- 2.1 In the last month there has been media coverage of Local Government LOBOs borrowing and information on LOBOs and the LOBOs currently held by Highland Council is below at Appendix 2.
- 2.2 Lender option borrower option (LOBO) is a long term borrowing instrument available in the UK. These financial instruments involve periodic interest re-fixings, which incorporates two linked options
- lender's option: option for the lender to set revised (usually higher) interest rates at predetermined interest reset dates - for example annually.
 - borrower's option: linked option for the borrower (exercisable only if the lender's option is exercised) either to pay the revised interest rate, or else to redeem the bond at par. Should the borrower wish to repay when the lenders option has not been exercised this would typically involves large breakage fees.

LOBOs are provided by banks and the loan contract runs for between 40 and 70 years.

- 2.3 The Council has 13 LOBOs and details of all these are in Appendix 2. The LOBOs were taken out for the following reasons:
- an initial lower rate was applied for the first few years which was comparable or lower than the interest rate at that time provided by the PWLB (PWLB is the treasury agency for Local Authority borrowing). Information on the PWLB rates when these LOBOs were borrowed are in Appendix 2.
 - a benefit of these LOBOS is that at a pre-agreed point, if the bank wants to vary the rate, the local authority has the option to walk away, without penalty.
 - In a climate of high and rising interest rates these offered value by providing longer term certainty with the option to repay the borrowing if the bank raised interest rates. During 2003/04, PWLB loans could not be taken out for periods greater than 30 years.
- 2.4 The Council regularly reviews the debt portfolio and actively looks for opportunities to restructure debt in order to make savings. In 2005, following such a review of the portfolio, loan rescheduling was undertaken and some of the terms of these LOBOs were re-negotiated (see Appendix 2).

- 2.5 In the current economic climate of low interest rates, the breakage costs on these LOBOs are expensive. However the same can be said for PWLB loans and that is reason why in recent years no early redemptions have taken place on the Council's loan portfolio. Council Officers will, of course, continue to monitor breakage costs.
- 2.6 The Council Officers meet quarterly with Treasury Advisers and a regular agenda item is discussion of the debt portfolio which would cover any opportunities for debt rescheduling.
- 2.7 The majority of our borrowing is sourced from the Treasury (PWLB loans) which offers the best rates currently.

3. Implications

- 3.1 The resource implications are covered in the attached tables. There are no Legal; Equalities; Climate Change/Carbon Clever; Risk; Gaelic or Rural implications relating to this report.

4. Recommendation

It is recommended that the Committee consider the Treasury Management Summary of Transactions reports.

Please see attached Tables

Designation: Director of Finance
Date: 14 August 2015
Author: David Robertson, Head of Corporate Finance
Background Papers: Loan Documentation, Financial Ledger

Treasury Management - Summary of Transactions for the Month to 30 April 2015

Type of Borrowing	Outstanding debt at start of month £	Raised £	Repaid £	Outstanding debt at end of month £	Average Interest Rate	
					beg %	end%
Public Works Loan Board	628,130,650	0	0	628,130,650	4.91	4.91
Mortgage Bonds	118,056,000	0	0	118,056,000	4.87	4.87
Temporary Loans	15,000,000	20,000,000	(12,000,000)	23,000,000	0.48	0.42
Bank Balance	(283,797)	125,969	0	(157,828)		
GROSS EXTERNAL BORROWING	760,902,853	20,125,969	(12,000,000)	769,028,822		
<i>Temporary Deposits</i>	(65,323,900)	(63,431,200)	48,735,200	(80,019,900)	0.51	0.51
NET EXTERNAL BORROWING	695,578,953	(43,305,231)	36,735,200	689,008,922		
Total average					4.70	4.77

Borrowing / Lending internal parameters as per approved Treasury Management Practices **Actual %** **Approved Max%**

Short term borrowing (net of investments) as % of the Council's outstanding long term debt	(7.66)	25.00
Borrowing at variable rates of interest as % of the Council's total outstanding loan debt	8.11	35.00

Treasury Management - Summary of Transactions for the Month to 31 May 2015

Type of Borrowing	Outstanding debt at start of month £	Raised £	Repaid £	Outstanding debt at end of month £	Average Interest Rate	
					beg %	end%
Public Works Loan Board	628,130,650	1,300,000	0	629,430,650	4.91	4.90
Mortgage Bonds	118,056,000	0	0	118,056,000	4.87	4.87
Temporary Loans	23,000,000	8,000,000	0	31,000,000	0.42	0.41
Bank Balance	(157,828)	67,915	0	(89,913)		
GROSS EXTERNAL BORROWING	769,028,822	9,367,915	0	778,396,737		
<i>Temporary Deposits</i>	(80,019,900)	(91,839,500)	90,912,600	(80,946,800)	0.51	0.48
NET EXTERNAL BORROWING	689,008,922	(82,471,585)	90,912,600	697,449,937		
Total average					4.77	4.72

Borrowing / Lending internal parameters as per approved Treasury Management Practices **Actual %** **Approved Max%**

Short term borrowing (net of investments) as % of the Council's outstanding long term debt	(6.69)	25.00
Borrowing at variable rates of interest as % of the Council's total outstanding loan debt	5.00	35.00

Treasury Management - Summary of Transactions for the Month to 30 June 2015

Type of Borrowing	Outstanding debt at start of month £	Raised £	Repaid £	Outstanding debt at end of month £	Average Interest Rate	
					beg %	end%
Public Works Loan Board	629,430,650	0	0	629,430,650	4.90	4.90
Mortgage Bonds	118,056,000	0	0	118,056,000	4.87	4.87
Temporary Loans	31,000,000	2,000,000	(2,000,000)	31,000,000	0.41	0.41
Bank Balance	(89,913)	0	(239,243)	(329,156)		
GROSS EXTERNAL BORROWING	778,396,737	2,000,000	(2,239,243)	778,157,494		
<i>Temporary Deposits</i>	(80,946,800)	(50,040,062)	46,001,810	(84,985,052)	0.48	0.48
NET EXTERNAL BORROWING	697,449,937	(48,040,062)	43,762,567	693,172,442		
Total average					4.72	4.72

Borrowing / Lending internal parameters as per approved Treasury Management Practices **Actual %** **Approved Max%**

Short term borrowing (net of investments) as % of the Council's outstanding long term debt	(7.27)	25.00
Borrowing at variable rates of interest as % of the Council's total outstanding loan debt	6.20	35.00

**The Highland Council - Finance, Housing and Resources Committee
Treasury Management - Prudential Indicators**

a) External Debt

Month	Authorised Limit*	Operational Boundary**	Month End	Min Position during month	Max Position during month
30 April 2015	£924.3m	£907.1m	£769.2m	£759.2m	£769.2m
31 May 2015	£924.3m	£907.1m	£778.5m	£769.2m	£778.5m
30 June 2015	£924.3m	£907.1m	£778.5m	£778.5m	£780.5m

* **The Authorised Limit** represents an upper limit of borrowing that could be afforded in the short term but may not be sustainable over the longer term. This limit includes a risk assessment of exceptional events taking into account the demands of revenue and capital cash flows. The Authorised Limit gauges events that may occur over and above those transactions which have been included in the Operational Boundary. The limits effective from 01/04/15 are set out in the Treasury Management Strategy Statement 2015/16 (approved by Council 12/03/15).

** **The Operational Boundary** represents an estimate of the most likely, prudent, but not worst case scenario and provides a parameter against which day to day treasury management activity can be monitored.

b) Debt Net of Investments

Month	Upper Limit Fixed	Upper Limit Variable	Month End Fixed	Month End Variable
30 April 2015	£865.1m	£302.8m	£633.1m	£55.9m
31 May 2015	£865.1m	£302.8m	£662.4m	£35.1m
30 June 2015	£865.1m	£302.8m	£650.4m	£42.8m

c) Maturity Structure of Fixed Rate Borrowing

Fixed Rate Borrowing	Under 12 months	12 months and within 24 months	24 months and within 5 years	5 years and within 10 years	10 years and above
Upper Limit	30%	30%	30%	50%	100%
Lower Limit	N/A	N/A	N/A	N/A	25%
As at 30 April 2015	6.7%	3.0%	11.0%	8.9%	70.4%
As at 31 May 2015	7.7%	3.0%	10.9%	9.0%	69.4%
As at 30 June 2015	7.7%	3.0%	10.9%	9.0%	69.4%

Appendix 1

Credit worthiness policy and assessment

This Council uses the creditworthiness service provided by Capita Treasury Services. This service employs a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies
- Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments.

- All credit ratings are monitored from a weekly list which can be updated daily by Capita. The Council is alerted to changes to ratings of all three agencies as these occur through its use of the Capita creditworthiness service.
- If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, immediate consideration will be given to whether funds should be withdrawn from this counterparty and the timescale for doing this.
- In addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

Based on the Capita approach, the Council will therefore use counterparties within the following durational bands:

Purple	2 years
Blue	1 year (only applies to nationalised or semi nationalised UK Banks)
Orange	1 year
Red	6 months
Green	100 days
No Colour	Not to be used

Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

In relation to Money Market Funds, the Council will use Capita's weekly investment monitor, and other regular updates, to ensure its MMF counter-parties meet the minimum credit criteria described in the table above.

As set out within the Prudential Indicators, a limit is set on the value of Treasury Investments which can be invested for more than 364 days. The limit is £20m, which represents the maximum sum invested for longer than 364 days, though the period of investment must be decided using Capita credit ratings and maximum limits in permitted investments.

Stage 3 – Counter-party Limits

The limits described below apply to the Council's treasury management operations. Separate limits apply for the Pension Fund, with Highland Council limits relating to all operations excluding the Pension Fund.

Due to market volatility in treasury management investments and varying levels of investment it is possible that at any time in the year, one category of investment could represent 100% of the portfolio although it is likely that investments will carry greater diversification than this.

No more than £15m can be invested with any single counterparty, with the exception of the nationalised or semi nationalised UK banks where no more than £25m can be invested in each bank.

The Council will place overnight and call deposits with the Council's bankers irrespective of credit rating. The limit on placing call deposits with the Council's bankers (when the rating does not match any of the durational bands advised by Capita) is £10m.

The Highland Council Pension Fund will place overnight and call deposits with the Council's bankers irrespective of credit rating. The limit on placing call deposits with the Council's bankers (when the rating does not match any of the durational bands advised by Capita) is £10m.

List of Counterparties, counterparty limit and credit rating

The following table is a list of current counterparties used, the Capita credit rating as at 30 June 2015 and amounts deposited.

Counterparty	Total amount £	Counterparty limit £	Capita credit rating (Jun-15)	Amount £	Deposit Type*	Rate % (Jun-15)	Duration Days
Nationwide Building Society	12,000,000	15,000,000	Red - 6 months	2,000,000	FTD	0.46	64
				2,000,000	FTD	0.46	59
				5,000,000	FTD	0.48	77
				3,000,000	FTD	0.47	70
Bank of Scotland	10,100,000	15,000,000	Red - 6 months	100,000	Call	0.40	N/A
				5,000,000	FTD	0.57	148
				5,000,000	FTD	0.50	79
Clydesdale Bank	8,385,052	10,000,000	No colour - zero	8,200,000	Call	0.50	N/A
				185,052	CMA	0.10	Overnight
Royal Bank of Scotland	0	25,000,000	Blue -12 months	0	Call	0.25	N/A
Barclays	15,000,000	15,000,000	Red - 6 months	15,000,000	Call	0.50	N/A
Santander	400,000	15,000,000	Red - 6 months	300,000	Call	0.40	N/A
				100,000	30 day notice	0.45	N/A
Goldman Sachs	5,000,000	15,000,000	Green - 100 days	5,000,000	FTD	0.53	92

Counterparty	Total amount £	Counterparty limit £	Capita credit rating (Jun-15)	Amount £	Deposit Type*	Rate % (Jun-15)	Duration Days
Standard Life Investments (previously Ignis)	15,000,000	15,000,000	Triple A rated	15,000,000	Call	0.48	N/A
Insight Investments	15,000,000	15,000,000	Triple A rated	15,000,000	Call	0.44	N/A
Svenska Handelsbanken	4,100,000	15,000,000	Blue -12 months	4,100,000		0.40	N/A
TOTAL DEPOSITS	84,985,052			84,985,052			

* Deposit Type – Fixed Term Deposit (FTD), Cash Management Account (CMA)

As stated in the Treasury Management Strategy statement for unavoidable short term operational reasons, limits are occasionally breached and this is communicated to management immediately.

Appendix 2 – All LOBOs currently held by Highland Council

Lender	Start Date	End Date	Amount borrowed	Rate	Rate info	PWLB rates at time LOBO was taken out
Prudential M & G	04/08/1989	04/08/2015	£1,000,000	10.875%	Inherited from Ross & Cromarty D.C. Initial rate 10.8125%. April 2007 rate change to 10.875%.	9.875%
Prudential M & G	07/03/1985	09/03/2020	£500,000	11.375%	Inherited from Ross and Cromarty D.C. Initial rate 11.375% and still applies.	11.250%
Prudential M & G	07/03/1985	09/03/2020	£500,000	11.375%	Inherited from Lochaber D.C. Initial rate 11.375% and still applies.	11.250%
Prudential M & G	19/11/1984	09/03/2020	£500,000	11.750%	Inherited from Ross and Cromarty D.C. Initial rate 10.75%. Changed to 11.75% 24/10/1997.	11.250%
Bank Of Scotland	30/09/2002	30/09/2042	£5,000,000	4.500%	Initial rate 2.80% until 30/09/2004 and then 4.50% onwards.	4.63%
Coventry Building Society	12/12/1990	12/12/2050	£1,000,000	11.125%	Inherited from Lochaber D.C. Initial rate 11.125% Lender has option on any day after 12/11/91 to change terms of loan giving 1 months' notice. If new terms not agreed, borrower may repay loan on expiry of notice period.	10.375%
Dexia Public Finance Bank	26/10/2004	26/10/2054	£8,750,000	4.340%	Initial rate 4.34% until 27/10/2014 and rate has continued. Lender has option to propose a change in interest rate subject to 4 business days prior notice. If the Council does not accept the revision the loan may be repaid without penalty.	4.650%
Barclays Bank Plc	03/08/2004	03/02/2065	£11,900,000	5.050%	Initial rate 3.75% and rate increase to 5.05% on 4/08/2008. HC completed loan rescheduling in September 2005. Rate changed to 3.55% until 4/08/2008 and then increased to 5.05%.	4.900%

Lender	Start Date	End Date	Amount borrowed	Rate	Rate info	PWLB rates at time LOBO was taken out
Dexia Public Finance Bank	14/03/2003	16/03/2065	£10,000,000	4.400%	Initial rate 1.80% until 14/03/2005 and then 4.40%. HC completed loan rescheduling in September 2005. Rate changed to 1.80% fixed to 16/03/2009 and then rate increased to 4.40%.	4.600%
Dexia Public Finance Bank	14/03/2003	16/03/2065	£11,740,000	4.400%	Initial rate was 3.25% and rate increase to 4.40% on 14/03/2007 (agreed 11/03/2003). HC completed loan rescheduling in September 2005 which resulted in rate being reduced to 2.75% and then rate increased to 4.40% on 14/09/2007.	4.600%
Barclays Bank Plc	02/12/2003	02/12/2065	£25,200,000	5.000%	Initial rate was 4.15% until 02/12/08 and after increasing to 5% (agreement 28/11/2003). HC completed loan rescheduling in September 2005. Rate then changed on 02/12/2005 to 3.70% until 02/12/2008 and after than increasing to 5%.	5.000%
Barclays Bank Plc	02/12/2003	02/12/2065	£25,000,000	5.000%	Initial rate was 4.00% until 03/12/07 and after increasing to 5% (agreement 28/11/2003). HC completed loan rescheduling in September 2005. Rate then changed on 02/12/2005 to 3.40% until 02/12/2008 and after than increasing to 5%.	5.000%

Lender	Start Date	End Date	Amount borrowed	Rate	Rate info	PWLB rates at time LOBO was taken out
Barclays Bank Plc	23/03/2006	23/03/2066	£16,216,000	3.800%	M290052 Initial rate was 3.80%and this still applies.	5.000%