

The Highland Council

Resources Committee – 8 February 2017

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| Agenda Item | 10.a |
| Report No | RES/08/17 |

Treasury Management – Summary of Transactions

October, November and December 2016

Report by Director of Finance

Summary

This report on the treasury management transactions undertaken within the period is submitted to Committee for Members' scrutiny and in compliance with CIPFA's Code of Practice on Treasury Management.

1. Background

- 1.1 This report sets out treasury management transactions during the period (see **Appendix 1**), reflecting activity undertaken to manage the Council's cash flows, and borrowing to fund capital expenditure and compliance with the Council's prudential indicators (see **Appendix 2**).
- 1.2 In managing its borrowing requirement, the Council has historically taken medium to long term borrowing at the most opportune time, to take advantage of the lowest interest rates available.
- 1.3 The strategy for 2016/17 is to make the best use of the low rates currently available on temporary short term borrowing to minimise the cost of loans charges but to monitor long term borrowing rates and to act to minimise exposure to the risk of interest rate increases.

2. Borrowing undertaken

- 2.1 During the period October to December 2016, the following fixed rate Market borrowing was undertaken at a rate preferential to the equivalent rate offered by the Public Works Loan Board (1.13%).

| Month | Amount | Counterparty | Duration | Rate |
|---------------|--------|-----------------------------|--------------------|-------|
| November 2016 | £5.0m | London Borough of Islington | 2 years 15 days | 0.57% |

- 2.2 When managing the Council's cash flow, the Finance Service will consider temporary borrowing (duration of less than 1 year) opportunities, in order to meet the Council's short-term cash flow requirements. There was temporary borrowing of £69.5m undertaken in the period October to December 2016 and £53.5m of temporary loans were repaid during this period. The average rate for temporary loans as at 31 December 2016 was 0.32%.

2.3 The impact on balances of the above borrowing is shown in **Appendix 1**

3. Deposits

3.1 The rates on call accounts and money market funds for short term deposits continue to be low due to the current market environment and the Bank Rate is currently 0.25%.

3.2 When placing temporary deposits the Council uses a credit rating weekly list 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.

3.3 In order to increase counterparty capacity and access better rates, there was a recommendation in the Treasury Management Mid-year report that all individual counterparty limits are increased from £15m to £20m with the exception of RBS and Clydesdale which will remain at £25m and £10m respectively. This was approved at Resources Committee on 23 November 2016.

3.4 During October 2016 the Council placed a £10m deposit with DZ bank to cover cash flow requirements in March 2017. This complies with the Treasury Management Strategy, as DZ bank is a German bank (Germany has a triple A rating) and the Capita recommended duration for this bank is 0 - 12 months.

3.5 Details of the Council's investment policy, the credit rating of these counterparties, and deposits held as at 31 December 2016 are at **Appendix 3**.

3.6 The Council's Treasury Management Policy is regularly reviewed.

4. Implications

4.1 The borrowing undertaken at favourable interest rates, as detailed above, is forecast to result in an underspend in the loans charges budget of £0.15m. This figure depends on the level of capital expenditure undertaken.

4.2 There are no Legal; Equalities; Climate Change/Carbon Clever; Gaelic or Rural or Risk implications relating to this report.

Recommendation

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

Designation: Director of Finance

Date: 27 January 2017

Author: Edward Foster, Head of Corporate Finance

Background Papers: Loan Documentation, Financial Ledger

Appendix 1

Treasury Management - Summary of Transactions for the Month to 31 October 2016

| 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 | 638,658,650 | 0 | 0 | 638,658,650 | 4.84 | 4.84 |
| Fixed Market Loans | 28,000,000 | 0 | 0 | 28,000,000 | 1.10 | 1.10 |
| LOBO Market Loans | 116,306,000 | 0 | 0 | 116,306,000 | 4.79 | 4.79 |
| Temporary Loans | 84,000,000 | 23,500,000 | (17,000,000) | 90,500,000 | 0.37 | 0.33 |
| Bank Balance | (111,930) | 0 | (1,708) | (113,638) | | |
| GROSS EXTERNAL BORROWING | 866,852,720 | 23,500,000 | (17,001,708) | 873,351,012 | | |
| <i>Temporary Deposits</i> | (89,546,000) | (69,008,100) | 59,760,100 | (98,794,000) | 0.50 | 0.50 |
| NET EXTERNAL BORROWING | 777,306,720 | (45,508,100) | 42,758,392 | 774,557,012 | | |
| Total average | | | | | 4.28 | 4.24 |

Borrowing / Lending internal parameters as per approved Treasury Management Practices

| | Actual % | Approved Max% |
|---|-----------------|----------------------|
| Short term borrowing as % of the Council's outstanding long term debt | 11.5 | 25.00 |
| Borrowing at variable rates of interest as % of the Council's total outstanding loan debt | 13.3 | 35.00 |

Treasury Management - Summary of Transactions for the Month to 30 November 2016

| 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 | 638,658,650 | 0 | 0 | 638,658,650 | 4.84 | 4.84 |
| Fixed Market Loans | 28,000,000 | 5,000,000 | 0 | 33,000,000 | 1.10 | 1.10 |
| LOBO Market Loans | 116,306,000 | 0 | 0 | 116,306,000 | 4.79 | 4.79 |
| Temporary Loans | 90,500,000 | 34,000,000 | (25,000,000) | 99,500,000 | 0.33 | 0.31 |
| Bank Balance | (113,638) | 0 | (84,754) | (198,391) | | |
| GROSS EXTERNAL BORROWING | 873,351,012 | 39,000,000 | (25,084,754) | 887,266,259 | | |
| <i>Temporary Deposits</i> | <i>(98,794,000)</i> | <i>(63,602,300)</i> | 62,756,600 | <i>(99,639,700)</i> | 0.50 | 0.51 |
| NET EXTERNAL BORROWING | 774,557,012 | (24,602,300) | 37,671,846 | 787,626,559 | | |
| Total average | | | | | 4.24 | 4.18 |

Borrowing / Lending internal parameters as per approved Treasury Management Practices

| | Actual % | Approved Max% |
|---|-----------------|----------------------|
| Short term borrowing as % of the Council's outstanding long term debt | 12.6 | 25.00 |
| Borrowing at variable rates of interest as % of the Council's total outstanding loan debt | 13.1 | 35.00 |

Treasury Management - Summary of Transactions for the Month to 31 December 2016

| 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 | 638,658,650 | 0 | 0 | 638,658,650 | 4.84 | 4.84 |
| Fixed Market Loan | 33,000,000 | 0 | 0 | 33,000,000 | 1.02 | 1.02 |
| LOBO Market Loans | 116,306,000 | 0 | 0 | 116,306,000 | 4.79 | 4.79 |
| Temporary Loans | 99,500,000 | 12,000,000 | (11,500,000) | 100,000,000 | 0.31 | 0.32 |
| Bank Balance | (198,391) | 143,730 | 0 | (54,661) | | |
| GROSS EXTERNAL BORROWING | 887,266,259 | 12,143,730 | (11,500,000) | 887,909,989 | | |
| <i>Temporary Deposits</i> | (99,639,700) | (42,906,700) | 44,956,400 | (97,590,000) | 0.51 | 0.48 |
| NET EXTERNAL BORROWING | 787,626,559 | (30,762,970) | 33,456,400 | 790,319,989 | | |
| | | | | | 4.24 | 4.18 |

Borrowing / Lending internal parameters as per approved Treasury Management Practices

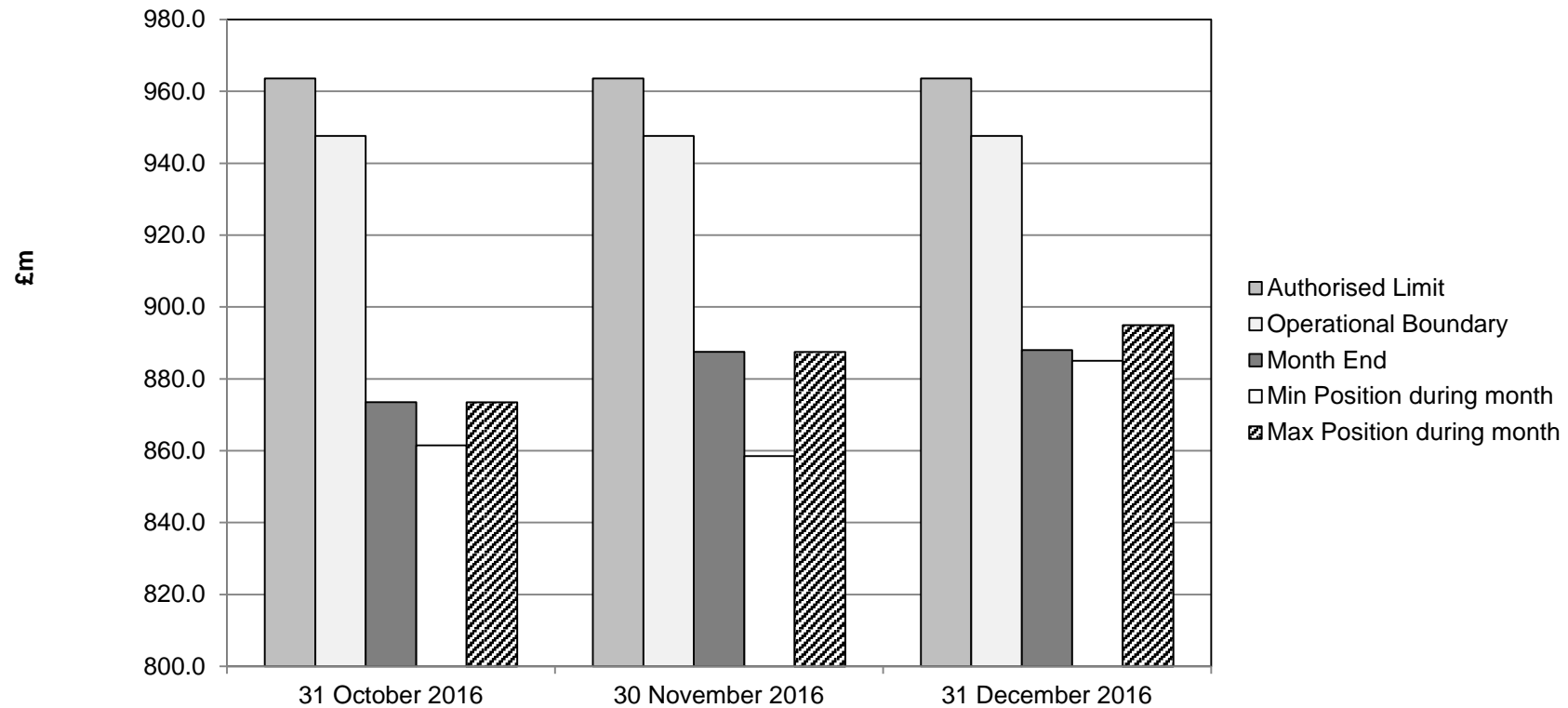
| | Actual % | Approved Max% |
|---|-----------------|----------------------|
| Short term borrowing as % of the Council's outstanding long term debt | 12.7 | 25.00 |
| Borrowing at variable rates of interest as % of the Council's total outstanding loan debt | 13.1 | 35.00 |

Appendix 2 The Highland Council - Resources Committee

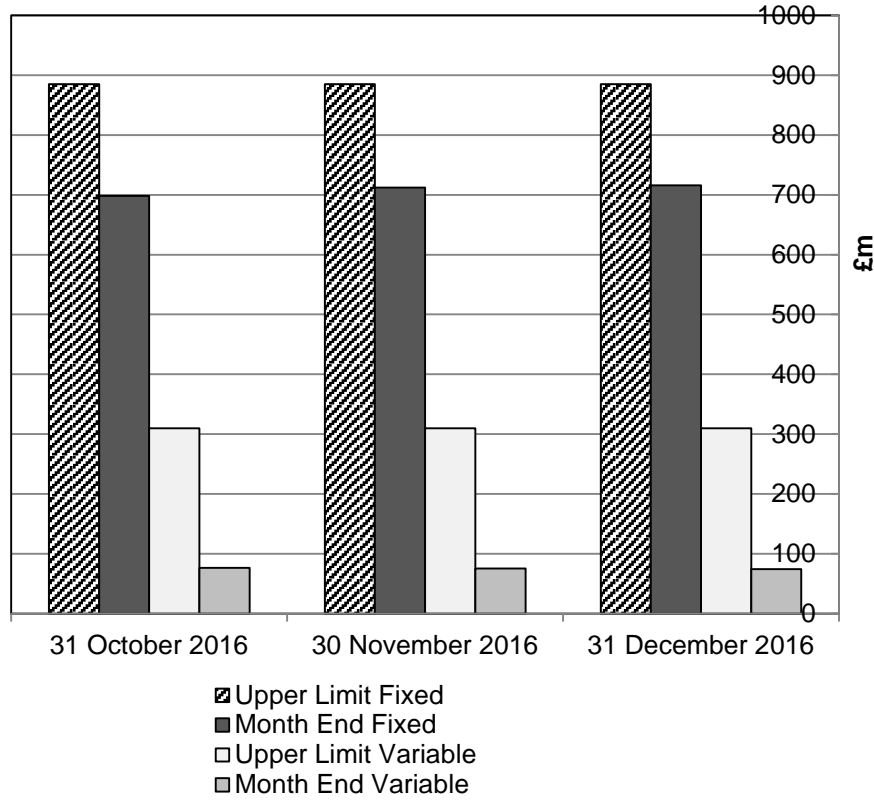
Treasury Management - Prudential Indicators

The Council has complied with all the prudential limits set in the Treasury Management Transactions Statement 2016/17.

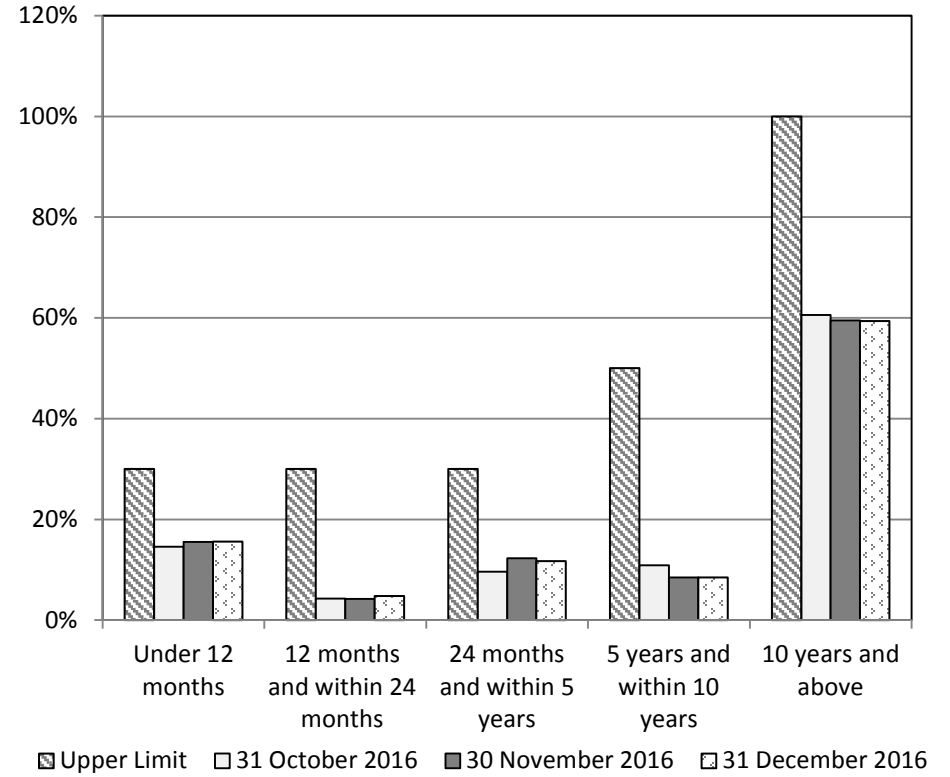
a) External Debt



b) Debt Net of Investments



c) Maturity Structure of Fixed Rate Borrowing



Appendix 3

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 daily 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 £20m 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 is currently £10m for the Highland Council bank accounts.

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 is currently £10m. The Pension Fund may also use other counterparties, with a £10m limit applying to each.

List of Counterparties, counterparty limit and credit rating

The following table is a list of current counterparties used, the Capita credit rating as at 31 December 2016 and amounts deposited with each counterparty. **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.*

| Counterparty | Total amount £ | Counterparty limit £ | Capita credit rating (Decr-16) | Amount £ | Deposit Type* | Rate % (Dec-16) | Duration Days |
|--------------------------------|-------------------|-------------------------|-----------------------------------|-------------------|------------------|--------------------|------------------|
| Bank of Scotland | 16,000,000 | 20,000,000 | Red – 6 mths | 11,000,000 | FTD | 0.65 | 181 |
| | | | | 5,000,000 | FTD | 0.45 | 90 |
| Clydesdale Bank* | 5,790,000 | 10,000,000 | No colour - zero | 5,790,000 | Call | 0.25 | N/A |
| | | | | 0 | CMA | 0.10 | Overnight |
| Commonwealth Bank of Australia | 5,000,000 | 20,000,000 | Orange – 12 mths | 5,000,000 | FTD | 0.53 | 184 |
| DZ Bank | 10,000,000 | 20,000,000 | Orange – 12 mths | 10,000,000 | FTD | 0.52 | 178 |
| Goldman Sachs International | 5,000,000 | 20,000,000 | Red – 6 mths | 5,000,000 | FTD | 0.62 | 177 |
| Insight Investments | 15,700,000 | 20,000,000 | Triple A rated | 15,700,000 | Call | 0.23 | N/A |
| Santander | 20,000,000 | 20,000,000 | Red - 6 months | 10,000,000 | 120 DN | 0.75 | 155 |
| | | | | 5,000,000 | 120 DN | 0.80 | 122 |
| | | | | 5,000,000 | 120 DN | 0.80 | 121 |
| Standard Life Investments | 20,000,000 | 20,000,000 | Triple A rated | 20,000,000 | Call | 0.30 | N/A |
| Svenska Handelsbanken | 100,000 | 20,000,000 | Orange – 12 mths | 100,000 | Call | 0.20 | N/A |
| TOTAL DEPOSITS | 97,590,000 | | | 97,590,000 | | | |