AGENDA ITEM NO. 5

NORTH LANARKSHIRE COUNCIL
REPORT

To: POLICY & RESOURCES (FINANCE & CUSTOMER SERVICES) SUB-COMMITTEE	Subject: TREASURY MANAGEMENT MONITORING REPORT PERIOD 1 OCTOBER TO 31 DECEMBER 2011
From: HEAD OF FINANCIAL SERVICES	
Date: 20 January 2012 Ref: PH/JQ/Q3	

1.0 Introduction

1.1 The purpose of this report is to inform on the quarterly activity (1 October 2011 to 31 December 2011) of the Council's loans and investment portfolios including the monitoring of the Prudential and Treasury indicators for the remainder of this financial year.

2.0 Background

2.1 The Council manages its treasury activities in line with the CIPFA Code "Treasury Management in the Public Services'. The Code requires the Council to produce reports on its Treasury Management policies, practices and activities on a regular and on-going basis. The Council fulfils these obligations in part by the preparation of a Treasury Management Monitoring report produced on a quarterly basis contained herein.

2.2 The Treasury activity undertaken in the third quarter of 2011/2012 reflects the key requirements of the Council's 2011/2012 Treasury Management Strategy, with the Public Works Loan Board and Long-term Money Market being the prime source of long-term funds. In addition, long term variable rate loans or temporary loans have not exceeded 25% of total borrowing. In terms of investment activity, all temporary lending is conducted with approved financial institutions.

3.0 Quarterly Activity

3.1 Summary Position

3.1.1 The net overall borrowing position to 31 December 2011 is shown in Appendix 1. The initial estimate of borrowing of £823.0m within the approved Treasury Management Strategy has been reduced to a projected requirement of £805.6m. Net borrowing at 31 December 2011 was £735.9m, an increase of almost £35.6m from the position at the 30 September 2011. This increase is primarily due to new long term borrowing of £30.0m undertaken, contributing towards the planned current year capital financing requirement, the replenishment of daily cash balances to meet daily revenue account demands and the repayment of maturing debt.

3.1.2 Investment balances are offset against the total external debt outstanding and therefore a reduction of £17.3m in these balances has also contributed towards the increased debt position. There was also an increase of £3.0m in the level of BACS payments outstanding and cheques unpresented at the 31 December 2011.

3.1.3 The aforementioned increases, totaling £50.3m have been partly offset by a net decrease of £10.9m in the level of temporary borrowing, a reduction of £2.3m in North Lanarkshire Municipal Bank deposits utilised by the Council, and also a £1.5m reduction in the liabilities outstanding in respect of Finance Lease and PPP obligations.

3.2 Debt Restructuring

3.2.1 During the quarter under review, in conjunction with our Treasury advisors, we monitored the economic climate in relation to our financial targets and Treasury Management strategy. The interest rates prevailing throughout the period resulted in no beneficial opportunities for debt restructuring/rescheduling of the PWLB debt portfolio arising.

3.2.2 Further reports regarding future activity will be presented to Committee as appropriate.

3.3. Borrowing

3.3.1 During the third quarter of 2011/2012 the Council borrowed £28.0m from the PWLB on a fixed term basis, the new debt maturity ranging from 10 to 10.5 years and fixed interest rates payable from 3.19% to 3.33%. The Council also borrowed £2m from another local authority on fixed rate terms of 1.20%, repayable in eighteen months, which represented good value given that PWLB were offering rates of 1.51% for similar terms.

3.3.2 The borrowing structure adopted helped smoothen out the debt maturity profile and the weighted average interest rate payable on the new debt was 3.14%. This is below the Council's current average loans fund pool rate of 5.76% and the projected interest rate on new borrowing costs of 5.0%, included within the estimates for 2011/2012. This will result in lower loan external interest payments as described within section 4.3 (iv) below.

3.3.3 At 31 December 2011, short-term borrowing amounted to £58.4m, which represented a decrease of £10.2m. Day to day cash flow needs were monitored resulting in temporary loan transactions totaling £39.6m in terms of cash repaid and £28.7m in cash received which resulted in an overall decrease of £10.9m by the end of the period. The period of the new borrowing ranging from thirty one days to 364 days, with the Council's liquidity and interest rate risk being managed effectively.

3.3.4 There was also a decrease of £2.3m in North Lanarkshire Municipal Bank deposits utilised by the Council offset by an increase of 3.0m in the level of BACS payments outstanding and cheques unpresented as described above.

3.3.5 In summary at the end of December, the Council has sourced almost £45m of new long term borrowing and approximately £7.1m of additional temporary borrowing (less than 1 year) since the start of 2011/2012 to fund its current year capital expenditure the balance being met from cash reserves and balances held and the annuity debt repayments due from services.

3.3.6 The timing and profile of the further borrowing will be managed giving full consideration to liquidity, interest rate and refinancing risk against a backdrop of continuing uncertainty within the economy, banking industry and financial markets.

3.4 Short Term Investments

3.4.1 In the third quarter of 2011/2012, management of cash-flows enabled short-term investments of £221.2m to be undertaken. During the same period, approximately £238.5m of short-term investments matured.

3.4.2 The net effect of these transactions was a decrease of £17.3m in investment balances as highlighted in paragraph 3.1.2.

3.4.3 The Council in line with the approved strategy to manage liquidity maintained a minimum balance of £5m available on an overnight basis (instant access) throughout the quarter. This ensured that the Council maintained the necessary prudent level of funds to meet all business/service objectives.

3.4.4 The Council demonstrated good performance levels in investment activity during the quarter with the investment rate achieved from investing surplus funds being consistently higher than the 7 day and 1 month LIBID (London Inter-bank Bid Rate) rate, and the Council's Instant Access Account .

3.4.5 During the third quarter, Moody's, one of the leading rating agencies downgraded the ratings of 12 UK financial institutions and confirmed the rating of 1 institution. These downgrades do not reflect any deterioration in the financial strength of the banking system or that of the government, the downgrades being caused by Moody's re-assessment of the support environment in the UK and the likelihood that the government will continue to provide some level of support to systematically important financial institutions.

3.4.6 On the 16 January 2012, Standard and Poors, another of the leading rating agencies, took rating action on 16 Eurozone sovereigns, the main impact being the affirmation of the "AAA" sovereign rating for Germany and the Netherlands, the long-term rating of France being downgraded by one notch to "AA+", with a raft of other countries including Spain ("A") whose ratings were downgraded by 2 or more notches. This reflects their assessment, that the policy initiatives that have been taken by European policymakers in recent weeks may not be enough to fully address ongoing systematic stresses in the Eurozone.

3.4.7 Whilst the Council's approach to investment strategy and assessment of creditworthiness remains robust, it will closely monitor developments and take the appropriate action to manage the Council's Treasury Management risk.

3.4.8 The Treasury Management team continues to take a prudent approach to investing surplus funds in line with the approved 2011/2012 Investment Strategy.

3.5 Interest Rate Movements

3.5.1 In the third quarter of 2011, at each of its meetings in October, November and December the Monetary Policy Committee (MPC) decided to retain the Bank of England base rate at 0.50%.

3.5.2 During the quarter, the short term 7 day LIBID rate, despite the general turmoil within the economy, as in previous months remained fairly stable around the 0.5% mark with the rate expected to remain on hold for a considerable time as the recovery in the economy remains insipid.

3.5.3 The impact of the current turmoil within the global economy continued to be demonstrated during the third quarter by an analysis of the erratic fluctuations in PWLB medium to long term rates as the flight of investment funds to safe haven UK gilts intensified. This resulted in PWLB rates falling even lower than the rates seen in the previous quarter which at that time were considered historically low. For example at the start of the financial year the PWLB 25 year borrowing rate was 5.36%, and in quarter 1 and quarter 2 fell as low as 5.09% and 4.41% respectively and in this quarter rates have fallen to as low as 3.96%, averaging levels of 4.75% throughout the year.

3.5.4 There still remain a number of uncertainties within the global economic environment including the risk of the US, UK and EU falling into recession, the eurozone debt crisis and the degree to which government austerity programmes will dampen economic growth. Whilst the current economic uncertainty exists and the fragility of the banking sector remains, day to day investment activity is within the short term horizon (less than 3 months) with the main focus being the security of the investment.

3.5.5 The impact of lower interest rates is that income earned from investing surplus cash balances is reduced but as mentioned earlier the Council continues to demonstrate good performance levels in investment activity.

3.5.6 The Treasury Management Section will continue to monitor financial and economic policy and their impact upon the Council's investment and borrowing activity.

4.0 The Prudential Code for Capital Finance in Local Authorities

4.1 The Local Government in Scotland Act 2003 requires the Council to undertake its Treasury activities with regard to the Prudential Code for Capital Finance in Local Authorities.

4.2 Committee, at its meeting on 2 March 2011, approved a report titled, "Treasury Management Strategy 2011/2012 and Treasury and Prudential Indicators 2011/2012 to 2013/2014". This report detailed a variety of mandatory and local indicators aimed at assisting members to determine that proposed capital investment levels and treasury management decisions satisfied the key requirements of affordability, prudence and sustainability. Performance against key prudential indicators for 2011/2012 is detailed within Appendix 2.

4.3 Committee will wish to note the following salient points:-

(i) Indicator 1(a) illustrates that investment on capital expenditure is anticipated to be higher than forecast in the Treasury Mgt Strategy, primarily due to slippage carried forward from the 2010/2011 Capital Programme and additional capital expenditure funded from external sources including the ongoing development of the Council's Waste Management Strategy . This is monitored in detail as part of the Council's capital programme reporting mechanisms. This will result in a small increase in the level of borrowing required to meet the Capital Programme with higher than anticipated capital grants and revenue contributions also contributing towards the increased expenditure programme.

(ii) The Prudential Code requires the Council's capital investment to be affordable and prudent. To demonstrate this, a Prudential Margin (the need to borrow versus actual borrowing) is calculated. Indicator 1(b) demonstrates a healthy prudential margin at the 31 December 2011. The net borrowing requirement is lower at this point in time as the current year capital financing requirement to date has been funded using internal cash balances and short term borrowing, with the timing and profile of the further borrowing managed giving full consideration to liquidity, interest rate and refinancing risk.

(iii) Indicator 2 illustrates that both the overall authorised and operational borrowing limits for borrowing and long term liabilities have not been exceeded, with the maximum borrowing undertaken within the period being well below the approved boundaries. A revised set of indicators for both the authorised limit and operational boundary for long term liabilities was approved at the end of Quarter 1 to reflect updates to finance lease arrangements for buildings, the information for which was not available when the 2011/12 prudential limits were finalised in February 2011.

(iv) Indicator 3(a) sets upper limits on the Council's exposure to the effects of interest rate changes by setting limits for each category of debt held (fixed or variable rate) which subsequently limits the Council's interest payable that is fixed or variable. During the third quarter of 2011/2012, the actual levels remained below the limits for the fixed and variable interest rate exposure limits.

(iv) Indicator 3(b) highlights a reduction of £4.9m in net loan external interest payments compared to the prudential estimates for 2011/2012. External interest payments show a favourable variance of £4.9m reflecting lower external debt levels carried forward from 2010/2011 due to a reduced borrowing requirement in this year. There is also a revised profile in respect of the timing of new borrowing managing investment security, liquidity and interest rate risk, given the current balances and reserves held and short term borrowing opportunities mentioned previously. In addition savings have been achieved as the weighted average interest rate payable to date on new long term borrowing undertaken is 3.09% which compares favourably with the projected interest rate on new borrowing costs of 5.0% included within the estimates for 2011/2012.

(v) Yields from investing surplus balances in 2011/2012 are expected to be on target due to the average levels of cash balances held being higher than anticipated. This has compensated for the anticipated increase in the Bank of England base rate in the early part of the year failing to materialise.

(vi) Indicator 3(c) relates to the level of fixed debt due to mature within time periods. The level of debt maturing remains within the upper limits set for each category at the beginning of the financial year.

4.4 The prudential indicators have remained in accordance with those approved by Committee on 2 March 2011. The projected final outturn illustrates a healthy prudential margin and borrowing levels that are below sustainable limits, ensuring that the projected capital investment levels remain affordable and sustainable.

5.0 Recommendation

5.1 It is recommended that Committee:

(i) Notes the treasury management activity for the quarter ended 31 December 2011, including the positive performance against the key prudential indicators.

Head of Financial Services

For further information please contact Joseph Quinn, Treasury Manager on tel ext 2061.

LOANS , LONG TERM LIABILITIES & INVESTMENTS AS AT 31 DECEMBER, 2011

APPENDIX 1

	BALANCE 01-Oct-11	DEBT RESTRUCTURING EARLY REDEMPTION	DEBT RESTRUCTURING REFINANCING	NEW BORROWING	PRINCIPAL REPAYMENTS	NET CASH MOVEMENTS	BALANCE 31-Dec-11
LONG-TERM LOANS							
PWLB	396,829,903	0	0	28,000,000	(27,392)	0	424,802,511
MONEY MARKET LOANS	109,000,000	0	0	2,000,000	0	0	111,000,000
MUNICIPAL BANK	10,000,000	0	0	0	0	0	10,000,000
	515,829,903	0	0	30,000,000	(27,392)	0	545,802,511
SHORT-TERM LOANS							
TEMPORARY	38,000,000	0	0	28,700,000	(39,600,000)	0	27,100,000
MUNICIPAL BANK	25,091,476	0	0	0	(2,288,352)	0	22,803,124
INTERNAL LOANS	6,280	0	0	0	0	0	6,280
BACS/CHEQUES UNPRESENTED	5,464,930	0	0	3,005,615	0	0	8,470,545
	68,562,686	0	0	31,705,615	(41,888,352)	0	58,379,949
LONG -TERM LIABILITIES							
FINANCE LEASE OBLIGATIONS	12,892,904	0	0	0	(585,976)	0	12,306,928
PPP LONG TERM LIABILITY	146,180,500	0	0	0	(919,750)	0	145,260,750
	159,073,404	0	0	0	(1,505,726)	0	157,567,678
TOTAL EXTERNAL DEBT	**743,465,992**	**0**	**0**	**61,705,615**	**(43,421,470)**	**0**	**761,750,137**
INVESTMENTS							
CASH IN HAND	854,743	0	0	0	0	(250,101)	604,642
OUTSIDE AGENCIES INCL CALL & TRACKER A/CS	42,252,301	0	0	0	0	(17,044,447)	25,207,854
CLYDESDALE BANK - INSTANT ACCESS	23,000	0	0	0	0	(23,000)	0
TOTAL INVESTMENTS O/STANDING	**43,130,044**	**0**	**0**	**0**	**0**	**(17,317,548)**	**25,812,496**
NET BORROWING	**700,335,948**	**0**	**0**	**61,705,615**	**(43,421,470)**	**17,317,548**	**735,937,641**

Prudential Code for Capital Finance in Local Authorities

1. Capital Expenditure, Capital Financing Requirement and Prudential Margin

(a) **Capital Expenditure**

	Initial Estimate 2011/2012 (£000s)	Projected Outturn 2011/2012 (£000s)
Total Spend	192,324	200,606
Financed By:		
Borrowing	151,835	152,076
Capital Receipts	6,004	4,606
Cash Grants	27,139	33,205
Capital from Current Revenue	7,346	10,719

(b) **Prudential Margin Calculation**

	Initial Estimate 2011/2012 (£000s)	Position as at 31/12/11 (£000s)	Projected Outturn 2011/2012 (£000s)
Capital Financing Requirement	880,251	881,305	881,305
Net Borrowing requirement	823,008	735,938	805,690
Prudential Margin	57,243	145,367	75,615

2) **Authorised Limit and Operational Boundary**

	Initial Authorised Limit 2011/2012 (£m)	Initial Operational Boundary 2011/2012 (£m)	Revised Authorised Limit 2011/2012 (£m)	Revised Operational Boundary 2011/2012 (£m)	Maximum Borrowing Level Q3 2011/2012 (£m)
Borrowing	740	735	740	735	605.85
Other Long-term Liabilities	155	155	170	170	159.07
Totals	895	890	865	860	764.92

3. Treasury Management Indicators

a) **Interest Rate Exposures**

	Upper Limits 2011/2012 (%)	Position as at 30/12/11 (£000s)
Fixed Interest Rates	110.00%	82.69%
Variable Interest Rates	25.00%	17.31%

b) **Interest Payments & Income due on Loans Outstanding/Funds Invested**

	Initial Estimate 2011/2012 (£000s)	Projected Outturn 2011/2012	Variance (£000s)	%tage
Interest Payable on Fixed Rate Debt	28,802	23,618	-5,184	-18.00%
Interest Payable on Variable Rate Debt	4,837	5,112	275	5.68%
Total External Interest Payments	**33,638**	**28,729**	**-4,909**	**-14.59%**
External Interest Receivable	-250	-250	0	0.00%
Net Loan External Interest Charges	**33,388**	**28,479**	**-4,909**	**-14.70%**

c) **Maturity Structure of Borrowing**

	<12months	12 months to 2 years	2 to 5 years	5 to 10 years	10 to 20 years	20 to 40 years	>40 years
Upper Limit maturing :Fixed Rate Debt	10.00%	10.00%	20.00%	30.00%	30.00%	40.00%	40.00%
Lower Limit maturing :Fixed Rate Debt	0.00%	0.00%	0.00%	5.00%	10.00%	10.00%	10.00%
Maturity structure at the start of Q3	2.64%	1.72%	9.76%	17.91%	9.96%	29.84%	28.18%
Maturity structure at the end of Q3	2.45%	2.27%	10.43%	18.16%	12.82%	25.93%	27.95%