

PERTH AND KINROSS COUNCIL

27 February 2013

**TREASURY ACTIVITY AND COMPLIANCE REPORT
- 2012/13 QUARTER 3****Report by the Head of Finance****ABSTRACT:**

The purpose of this report is to provide a summary of Loans Fund transactions for the quarter ending 31 December 2012 and to report on compliance with the Council's Treasury Management Policy Statement (TMPS), Treasury Management Practices (TMP's) and the Investment Strategy for the same period.

1. RECOMMENDATIONS

- 1.1 It is recommended that the Council:
1. Notes the content of this report, which is submitted in accordance with the Council's approved Treasury Management Practices.
 2. Notes that the Prudential Indicators have not been updated in this report as revised indicators are submitted for approval within the "Treasury & Investment Strategy and Prudential Indicators 2013/14 – 2019/20" report on the agenda for this meeting.

2. BACKGROUND

- 2.1 Treasury Management Practice 6 (TMP6 - Reporting Requirements & Management Information Arrangements) requires that Loans Fund borrowing and lending activities are reported quarterly to the Council. This report covers the period from 1 October to 31 December 2012. TMP6 also requires that compliance with the approved TMPs, Treasury Policies and Investment Strategy are reported quarterly and this report also covers compliance for the period. The Prudential Indicators are also monitored throughout the year and reported as part of the quarterly Treasury Activity and Compliance report. However these indicators are subject to revision under a separate report to this meeting of the Council, and are therefore not covered in this report.

3. ECONOMIC BACKGROUND

- 3.1 The Bank of England Monetary Policy Committee (MPC) kept the Bank Rate at 0.5% throughout the quarter. The MPC also held the quantitative easing programme (aimed at encouraging economic activity) at a total of £375 billion.
- 3.2 Gross Domestic Product (GDP) fell by 0.3% in the last quarter of 2012. Contributing factors to this were a fall in mining and quarrying, and maintenance delays at the UK's largest North Sea oil field. In the Government's Autumn statement, austerity measures were extended by a further year, to 2017/18, following poorer Government borrowing forecasts.

- 3.3 UK retail sales in the quarter fell by 0.7%. The rate of inflation (Consumer Price Index) rose from 2.2% in September to 2.7% in October and remained at that level in November. The increase in university tuition fees, rises in utility prices, and increases in food prices following poor harvests mean that inflation is predicted to remain between 2.5% and 3% for most of 2013. UK unemployment fell by 3,000 in November, while the Labour Force Survey measure of employment rose by 40,000 in the three months to October. However, this was the smallest increase since the start of the year. Pay growth continued to remain weak with annual growth of overall average earnings dropping from 1.8% in June to 1.3% in October.
- 3.4 The housing market showed mixed signals. Both the Nationwide and Halifax indicators showed a reduction in prices in comparison to last year. Mortgage approvals for new house purchases, however, rose to a total of 52,982 in October and was the fifth consecutive monthly rise.
- 3.5 Internationally, the US economy contracted by 0.1% in the last quarter. The total non-farm payroll (the main US measure of employment) rose in October and November. The agreement reached on 1st January to defer a resolution to the “fiscal cliff” scheduled for the start of 2013 reduced the risk of a new US recession. However, in the Eurozone, various economic activity indicators indicated a deepening recession.
- 3.5 The Public Works Loan Board’s (PWLB) fixed interest rates, which are based on market prices and yields on UK gilts, remained broadly the same over the quarter and remain low for all borrowing periods. Variable rates, which generally move in line with Bank Rate expectations, also remained static. Interest rate movements are shown in the graph at Appendix I.

4. TREASURY ACTIVITY

- 4.1 A summary of the Council’s treasury position and transactions is shown at Appendix II. This shows that the main activity during the quarter was the investment of short-term cashflow surpluses, mainly in notice deposit accounts. There were some fixed term investments for longer periods where the opportunity arose in line with cashflow forecasts and counterparty limits. There were no new fixed rate PWLB loans borrowed in the quarter, nor any short term borrowing transactions undertaken during the quarter. There was a repayment of a maturing fixed PWLB loan for £5M on the 3rd October 2012. The level of funds held on temporary loan by local trusts increased over the quarter in line with their own cash requirements.
- 4.2 The total amount of investments decreased over the quarter, closing at £54.775M compared with £60M at the end of the last quarter. This is expected to continue to fall further over the remainder of the year in line with the Council’s Treasury strategy. The average rate of interest earned on investments outstanding at the end of the quarter decreased slightly from 1.79% to 1.77%. The average lending period to Banks and Building Societies for fixed term deposits was 75 days, decreasing from the previous quarter’s average period of 172 days. This was because of the need to place deposits

with counterparties who had shorter approved lending periods and also in line with cashflow requirements. The average lending rate on fixed deposits also decreased from 1.32% in the previous quarter to 0.60%.

- 4.3 Most of the investment transactions in the quarter were through the Council's instant access and notice deposit accounts, to meet daily cashflow requirements. The average interest rate on these accounts for the quarter reduced from 0.72% to 0.64% in line with market rates generally. All of the above investment activities reflect the Council's current investment strategy and cashflow requirements.
- 4.4 There was no temporary borrowing undertaken during the quarter. Funds held from associated bodies and organisations increased over the quarter, from £1,643,505 to £2,349,199. This can be attributed to temporary borrowing undertaken by Tayside Fire & Rescue to meet their cashflow requirements. The average rate remained unchanged at 0.10%.

5. COMPLIANCE

- 5.1 For the quarter ending 31 December 2012, there were no breaches in compliance with the Council's approved Treasury Management Policy Statement, TMPs or lending limits (as detailed in Treasury Management Practice 4 TMP4 - Approved Instruments, Methods & Techniques).
- 5.2 TMP4 requires that a working list of specific approved counterparties (including lending limits) is maintained and updated regularly for any movements in credit ratings or Credit Default Swap prices. The Council's approved lending policy incorporates Sector Treasury Services' suggested maximum lending period for each counterparty. Appendix III shows the list of approved counterparties based on the current lending policy, as at January 2013.
- 5.3 A further requirement of TMP4 is that of cashflow performance measurement, which is expressed as the average closing cleared bank balance for the period. For the quarter ending 31 December 2012 the average closing cleared bank balance was £9,133.40 (credit). This is within the set target range of £50,000 (debit or credit).

6. INVESTMENT STRATEGY COMPLIANCE & PERFORMANCE

- 6.1 In essence, the Treasury Investment Strategy approved by the Council for 2012/13 (Report 12/78 refers) seeks to ensure security over principal sums invested whilst obtaining optimum returns consistent with this approach. Therefore, the only Permitted Investments approved are in low risk organisations. The limits for each Permitted Investment and individual counterparty ensure a good spread of investments thereby also spreading any risk. The Council also needs to ensure good liquidity at all times and, consequently investments must be made in accordance with cashflow requirements. The approved Strategy also seeks to reduce the level of investments during the current period of low investment returns and increased risks, subject to longer term funding requirements.

- 6.2 The strategy was applied in full over the quarter with no breaches in compliance with treasury limits, whilst liquidity was maintained by the use of instant access and notice deposit accounts as detailed in Section 4 above. The original Strategy also anticipated that investments would not exceed £50M during the year unless, for example, the Council undertook new long term borrowing. There was £10M new PWLB long term borrowing undertaken in the first quarter of the financial year, hence the level of investments exceeded the £50M level. However, the balance of investments is anticipated to reduce steadily in the final quarter.
- 6.3 There were no additional risks identified or borrowing in advance of need undertaken in the quarter.
- 6.4 The Investment Strategy also incorporates investments held by the Common Good Funds. All such investments during the quarter were in line with the approved strategy.
- 6.5 There were no Council funds, other than those relating to Charitable Trusts, held by external managers.
- 6.6 The Annual Property Investment Strategy for 2012/13 was also approved by the Council at its meeting on the 22 February 2012 (Report 12/78 refers) and is being complied with in full, with no breaches in compliance with permitted investment limits.
- 6.7 The income from the Council's property portfolio for 2011/12 was £1,987,000, which represents a reduction from the projected income figure of £2,060,000 reflecting a loss of rental income in the present financial climate.
- 6.8 The budgeted income for 2012/13 was projected in the Annual Property Investment Strategy at £1,987,000, however this is likely to be revised downward to £1,848,000 in light of the current economic and market conditions.
- 6.9 There were neither additional risks identified nor new property investments entered into in the quarter. The strategy action plan for the rationalisation of the commercial property portfolio remains on programme.

7 ICELANDIC BANKS

- 7.1 The funds repaid by Glitnir in Icelandic Krona (ISK) remain in an escrow account in Iceland in accordance with the requirements of the Icelandic Central Bank. The estimated value of the ISK amounts to £192,400 (as at 31 December 2012), which represents an increase of £4,500 from the previous valuation (31 March 2012). This increase relates to accrued interest on the funds (£5,800), offset by an unfavourable movement in the exchange rate (£1,300). There have been no other developments over the quarter in respect of these funds.

7.2 In January 2013, the European Free Trade Association (EFTA) Court ruled that the Icelandic Government did not require to reimburse depositors in the “Icesave” Bank (part of Landsbanki) for any loss not met by the Icelandic deposit guarantee scheme. Whilst this ruling has no bearing on the Council’s previous claim against Glitnir, there is currently market speculation that the ruling may lead to depreciation of the Icelandic Krona, which in turn would reduce the value of the Council’s funds held in Iceland. It might be possible to mitigate this risk by disposing of the Council’s ISK holding at a significant discount through a currency auction. However, it is considered that any devaluation of the currency is likely to be minimal, and therefore no action by the Council is proposed at this stage. Any future developments will be reported to the Council at the earliest opportunity.

8. PRUDENTIAL INDICATORS

8.1 The Prudential Indicators are normally monitored and updated as part of this Quarterly Activity and Compliance report. However, the indicators have been updated and submitted for approval within the “Treasury & Investment Strategy and Prudential Indicators 2013/14 – 2019/20” report for consideration at this meeting of the Council. The revised Prudential Indicators will continue to be monitored from the next Quarterly Treasury Activity and Compliance report.

9. CONSULTATION

9.1 All treasury activities described above were undertaken in consultation with the Council’s advisors, Sector Treasury Services Ltd. The Chief Executive was also consulted in the preparation of this report.

10. RESOURCE IMPLICATIONS

10.1 There are no resource implications arising directly from this report.

11. COUNCIL CORPORATE PLAN OBJECTIVES 2009 - 2012

11.1 The Council’s Corporate Plan 2009-2012 lays out five Objectives which provide clear strategic direction, inform decisions at a corporate and service level and shape the resources allocation. They are as follows:

- (i) A Safe, Secure and Welcoming Environment
- (ii) Healthy, Caring Communities
- (iii) A Prosperous, Sustainable and Inclusive Economy
- (iv) Educated, Responsible and Informed Citizens
- (v) Confident, Active and Inclusive Communities

11.2 The Chief Executive’s Service provides a range of functions for internal and front-line customers alike. Those functions support the work of the whole Council by assisting them in the delivery of the Council’s Corporate Objectives. As a consequence, this report does not specifically relate to one of the objectives, but assists with the delivery of all five.

12. EQUALITIES ASSESSMENT

- 12.1 The Council's Corporate Equalities Assessment Framework requires an assessment of functions, policies, procedures or strategies in relation to race, gender and disability and other relevant equality categories. This supports the Council's legal requirement to comply with the duty to assess and consult on relevant new policies to ensure there is no adverse impact on any community group or employees.
- 12.2 The function, policy, procedure or strategy presented in this report was considered under the Corporate Equalities Assessment Framework and the determination was made that the items summarised in this report do not require further assessment as they do not have an impact on people's wellbeing.

13. STRATEGIC ENVIRONMENTAL ASSESSMENT

- 13.1 Strategic Environmental Assessment (SEA) is a legal requirement under the Environmental Assessment (Scotland) Act 2005 that applies to all qualifying plans, programmes and strategies, including policies (PPS). The matters presented in this report were considered under the Environmental Assessment (Scotland) Act 2005 and no further action is required as it does not qualify as a PPS as defined by the Act and is therefore exempt.

14. CONCLUSION

- 14.1 The main activities during the quarter were the lending of surplus cashflow funds and the repayment of a fixed term PWLB loan on maturity. A limited number of fixed investments were made in line with cashflow forecasts for shorter time periods than previous quarters to keep within counterparty limits. Most investments were in short term call accounts and money market funds to maintain liquidity and counterparty spread. The Council adhered to its investment strategy and policies throughout the quarter.
- 14.2 The UK economy continued to give mixed signals. Inflation increased to 2.7%, and the Monetary Policy Committee maintained the Bank Rate at 0.5%. There was no further quantitative easing during the quarter.
- 14.3 The monitoring of the Prudential Indicators is not included in this report, but will continue to be monitored in the next quarterly report.

**JOHN SYMON
HEAD OF FINANCE**

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Background Papers: No background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973 (other than any containing confidential or exempt information) were relied on to any material extent in preparing the above report.

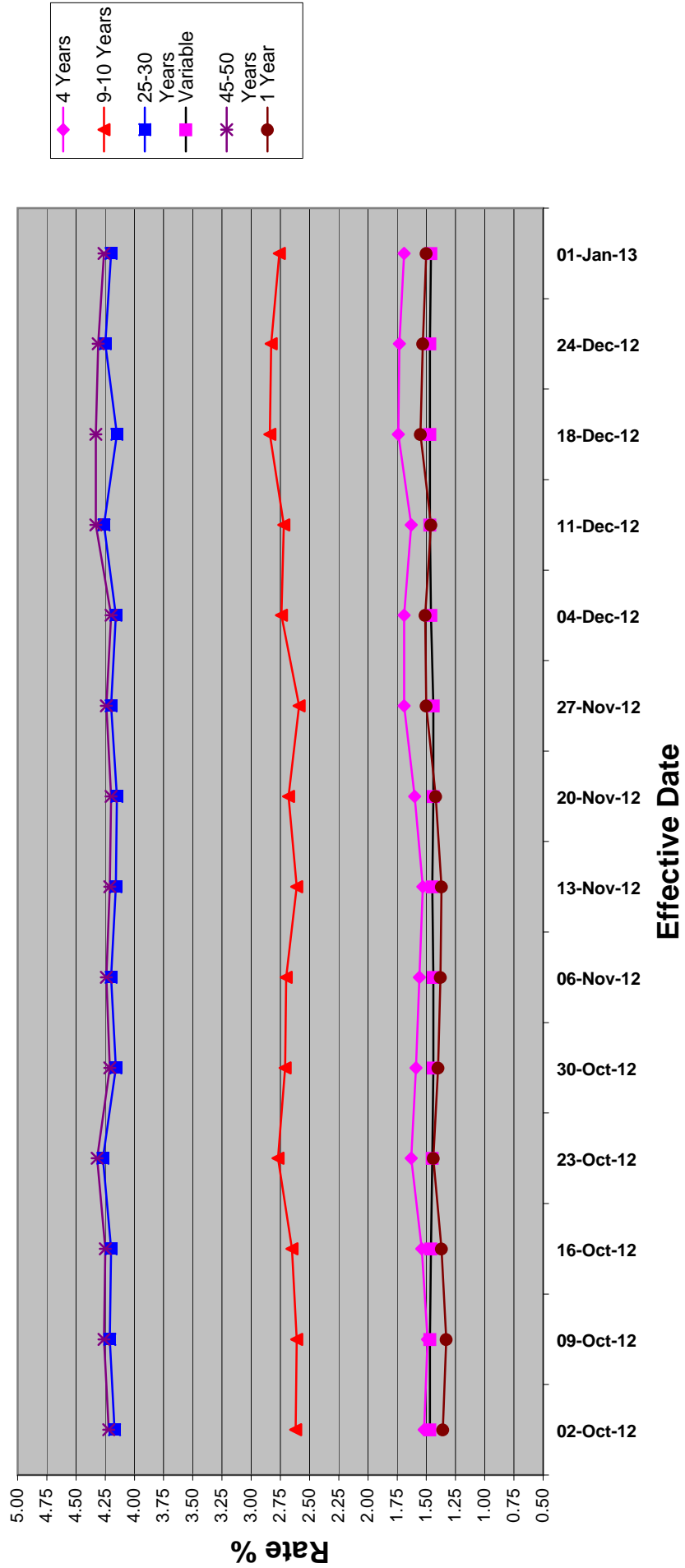
Quarterly Report.doc, Finance, 2 High Street, Perth
20 February 2013

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Council Text Phone Number 01738 442573

**PWLB Fixed Maturity & Variable Interest Rates
From 1 October to
31st December
2012**



1 LENDING

(a) <u>Investments Outstanding</u>	Outstanding 30-Sep-12	Average Rate	Outstanding 31-Dec-12	Average Rate
	£		£	
Banks (Fixed Deposits)	45,000,000	2.18%	44,050,000	2.09%
Money Market Funds	12,050,000	0.65%	5,725,000	0.48%
Building Societies/Subsidiary Banks (Fixed)	2,500,000	0.53%	5,000,000	0.48%
Other Local Authorities	468,600	0.50%	0	0.00%
TOTAL	60,018,600	1.79%	54,775,000	1.77%

(b) Investment Transactions - 1st October to 31st December 2012

<u>Fixed Deposits</u>	<u>No.</u>	<u>Average Amount (£)</u>	<u>Average Rate (%)</u>	<u>Average Term (Days)</u>	<u>Total Interest (£)</u>
Banks	7	3,435,714	0.63%	82	79,873.29
Building Soc/Subsidiary Banks	2	2,500,000	0.42%	46	2,645.89
TOTAL	9	3,227,778	0.60%	75	82,519.18

<u>Instant/Notice Accounts</u>	<u>Average Amount (£)</u>	<u>Average Rate (%)</u>	<u>Total Interest (£)</u>
Instant Access account	212	0.75%	5.83
95 day notice account	5,000,000	1.25%	2,054.79
Money Market Funds	5,957,885	0.55%	16,035.53
TOTAL	1,826,349	0.64%	18,096.15

2 BORROWING**(a) Long Term Borrowing 1st October to 31st December 2012**

	<u>No.</u>	<u>Average Rate (%)</u>	<u>Amount (£)</u>
PWLB - Maturity Loans	0	0.00%	0
	0	0.00%	0

(b) Long Term Debt Repayments 1st October to 31st December 2012

	<u>No.</u>	<u>Average Rate (%)</u>	<u>Amount (£)</u>
PWLB - Maturity Loan - Scheduled Repayment	1	4.08%	5,000,000
	1	4.08%	5,000,000

(c) Long Term Debt Outstanding

	Outstanding 30-Sep-12	Average Rate	Outstanding 31-Dec-12	Average Rate
	£		£	
Public Works Loan Board	169,935,129	3.98%	164,935,129	3.98%
Money Market Loans (LOBO's)	43,200,000	4.59%	43,200,000	4.59%
Other Long Term Debt	290,000	0.75%	290,000	0.75%
Total	213,425,129	4.10%	208,425,129	4.10%

(d) Temporary Borrowing Outstanding

	<u>Outstanding 30-Sep-12</u>	<u>Average Rate</u>	<u>Outstanding 31-Dec-12</u>	<u>Average Rate</u>
	£		£	
Banks and Building Societies	0	0.00%	0	0.00%
Other Local Authorities and Corporations	0	0.00%	0	0.00%
Local Trusts & Investors	1,643,505	0.10%	2,349,199	0.10%
TOTAL	<u>1,643,505</u>	<u>0.10%</u>	<u>2,349,199</u>	<u>0.10%</u>

(e) Temporary Market Borrowing - 1st October to 31st December 2012

	<u>No.</u>	<u>Average Amount (£)</u>	<u>Average Rate (%)</u>	<u>Average Term (Days)</u>	<u>Interest (£)</u>
Market Temporary Borrowing	0	0	0.00%	0.0	0.00
TOTAL	<u>0</u>	<u>0</u>	<u>0.00%</u>	<u>0.0</u>	<u>0.00</u>

PERTH AND KINROSS COUNCIL
APPROVED INVESTMENT COUNTERPARTY LIST

APPENDIX III

	<u>Country</u>	<u>Credit Rating</u>	<u>CDS Range</u>	<u>Maximum Lending</u>	<u>Note</u>
Category 1 - Principal UK Clearing Banks - max £10M per Counterparty unless semi-nationalised max £20M					
(Minimum rating required Fitch A, F1)					
Barclays Bank plc	UK	AA-, F1+	In range	3 months	
Lloyds Banking Group plc (incl HBOS and Bank Of Scotland) (1)	UK	AA-, F1+	Nationalised	12 months	Individual limit £20M
HSBC Bank plc	UK	AA, F1+	In range	12 months	
Royal Bank of Scotland plc (1)	UK	AA-, F1+	Nationalised	12 months	Individual limit £20M
Standard Chartered Bank	UK	AA-, F1	In range	12 months	

Category 2 - Foreign Banks & Institutions - max £7.5M per Counterparty

(Minimum rating required Fitch A, F1)

Australia and New Zealand Banking Group Lt	Aus	AA-, F1+	In Range	12 months	
Commonwealth Bank of Australia	Aus	AA, F1+	In Range	12 months	
National Australia Bank Ltd	Aus	AA, F1+	In Range	12 months	
Westpac Banking Corporation	Aus	AA, F1+	In Range	12 months	
Bank of Montreal	Can	AA-, F1+	No data	12 months	
Bank of Nova Scotia	Can	AA-, F1+	No data	12 months	
Canadian Imperial Bank of Commerce	Can	AA-, F1+	No data	12 months	
National Bank of Canada	Can	A+, F1	No data	6 months	
Royal Bank of Canada	Can	AA-, F1+	No data	12 months	
Toronto Dominion Bank	Can	AA-, F1+	No data	24 months	
Nordea Bank Finland plc	Finland	AA-, F1+	No data	6 months	
BNP Paribas	France	AA-, F1+	In Range	1 months	Sovereign Rating AA+
Credit Industriel et Commercial	France	AA-, F1+	No data	1 months	Sovereign Rating AA+
Deutsche Bank AG	Germany	AA-, F1+	In Range	6 months	
DZ Bank AG	Germany	A+, F1+	No data	3 months	
Landesbank Berlin AG	Germany	AA-, F1+	No data	3 months	
Landwirtschaftliche Rentenbank	Germany	AAA, F1+	No data	12 months	
Hong Kong and Shanghai Banking Corporation Ltd	Hong Kong	AA, F1+	No data	1 month	Sovereign Rating AA+
Banque et Caisse d'Epargne de l'Etat*	Luxemburg	AA+, A-1+	No data	6 months	
Clearstream Banking	Luxemburg	AA, F1+	No data	24 months	
Bank Nederlandse Gemeenten	Netherlandc	AAA, F1+	No data	24 months	
Co-operatieve Centrale Raiffeisen	Netherlandc	AA+, F1+	In Range	12 months	
ING Bank NV	Netherlandc	A+, F1+	In Range	3 months	
DnB NOR Bank	Norway	A+, F1	No data	6 months	
DBS Bank Limited	Singapore	AA-, F1+	In Range	12 months	
Oversea-Chinese Banking Corp Ltd	Singapore	AA-, F1+	In Range	24 months	
United Overseas Bank Ltd	Singapore	AA-, F1+	In Range	24 months	
Nordea Bank AB	Sweden	AA-, F1+	In Range	12 months	
Skandinaviska Enskilda Banken AB	Sweden	A+, F1	In Range	6 months	
Swedbank AB	Sweden	A, F1	In Range	3 months	
Svenska Handelsbanken AB	Sweden	AA-, F1+	In Range	12 months	
Credit Suisse	Switzerland	AA-, F1+	In Range	3 months	
UBS AG	Switzerland	A+,F1+	In Range	3 months	
Bank of New York Mellon	USA	AA-, F1+	No data	1 month	Sovereign Rating AA+
HSBC Bank USA, National Association	USA	AA, F1+	No data	1 month	Sovereign Rating AA+
JP Morgan Chase Bank NA	USA	AA-, F1+	In Range	1 month	Sovereign Rating AA+
Northern Trust Company	USA	AA-, F1+	No data	1 month	Sovereign Rating AA+
State Street Bank and Trust Company	USA	A+,F1+	No data	1 month	Sovereign Rating AA+
Wells Fargo Bank NA	USA	AA-, F1+	In Range	1 month	Sovereign Rating AA+

Category 3 - Subsidiary Banks & Building Societies - max £5M per Counterparty

(Minimum rating required Fitch A, F1)

(parent bank shown in brackets)

Subsidiary Banks

Building Societies

Nationwide Building Society	UK	AA-, F1+	In range	6 months	
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Category 4 - Other Local Authorities - max £10M per Counterparty

As arranged

**PERTH AND KINROSS COUNCIL
APPROVED INVESTMENT COUNTERPARTY LIST**

APPENDIX III

	<u>Country</u>	<u>Credit Rating</u>	<u>CDS Range</u>	<u>Maximum Lending</u>	<u>Note</u>
<u>Category 5 Money Market Funds - max £10M per Counterparty</u>					
(Minimum rating required Fitch AAA)					
Prime Rate Sterling Liquidity Fund (Class 3)	UK	AAA			
Deutsche Bank Sterling Fund	UK	AAA			
Insight Sterling Liquidity Fund (Class 5)	UK	AAA			
Royal Bank of Scotland GTF Sterling Fund (Class 4)	UK	AAA			
Ignis Sterling Liquidity Fund	UK	AAA			

Note:

(1) - Banks are part/majority owned by the UK government

Note - all Sovereign credit ratings for above Countries are AAA unless stated otherwise.

* Standard & Poor's Rating

Last Updated: 06-Feb-13