

**FALKIRK COUNCIL**

**Subject: TREASURY MANAGEMENT – INTERIM REVIEW 2014/15**  
**Meeting: EXECUTIVE**  
**Date: 2 December 2014**  
**Author: CHIEF FINANCE OFFICER**

**1. INTRODUCTION**

- 1.1 As part of the Treasury Management Code of Practice, reporting requirements make provision for a mid-year review of the Treasury Management function to be considered by the appropriate Committee and full Council.

**2. ECONOMIC AND INTEREST RATE OUTLOOK**

- 2.1 Council approved the Treasury Management Strategy for 2014/15 in May 2014. The Strategy highlighted that the UK economy appeared to be recovering with the Bank of England upgrading the forecasts for growth in 2014. The Strategy did advise caution highlighting that there needed to be more emphasis on construction, manufacturing, business investment and exporting in order for the recovery to become more firmly established. However indications are that this growth is likely to continue through 2014 and into 2015 with improvements in sectors such as construction and manufacturing. There have been further reductions in unemployment currently standing at 6.2% and inflation has fallen to 1.2% in September.
- 2.2 The Eurozone is facing an increasing threat from weak or negative growth and also from deflation. Continuing weaknesses in France and Italy will slow down recovery as will the declining economic activity of Germany. The U.S. has undergone reasonable economic growth in the last year, boosted by cuts in government spending and tax rises.
- 2.3 In the Strategy Report, there was an expectation that the Bank Rate would remain at 0.5%, until December 2015. However, recent economic data is suggesting that the rates will start to increase with effect from June 2015. In contrast long term rates have reduced from those rates included in the Strategy Report, albeit, these rates continue to be unpredictable.

- 2.4 The latest medium-term interest rate forecast as supplied by Capita Asset Services, the Council's treasury advisers, is as follows:

Annual Average %	Bank Rate	MONEY RATES		PWLB RATES			
		3 months	1 Yr	5 Yr	10 Yr	25 Yr	50 Yr
2014/15	0.50	0.45	0.89	2.55	2.76	3.30	3.29
2015/16	0.75	0.85	1.23	2.78	3.55	4.20	4.20
2016/17	1.25	1.55	1.95	3.15	3.95	4.63	4.63

### 3. BORROWING STRATEGY

- 3.1 The Council's estimated longer term borrowing requirement is set out below:

	<b>2014/15 Original Estimate</b>	<b>2014/15 Revised Estimate</b>
	<b>£m</b>	<b>£m</b>
Capital Programmes (net of receipts including TIF)	43.0	42.5
Service Payments	(13.4)	(12.9)
Short Term Loans maturing in year	<u>22.0</u>	<u>22.0</u>
Total Longer Term Borrowing Requirement	<u>51.6</u>	<u>51.6</u>

- 3.2 In the Strategy Report, it was noted that the Council's longer term borrowing requirement for the year would be significant. With this in mind, it was agreed to consider the complete range of borrowing periods as and when we needed to borrow. The table above includes £22.0m of short term debt that matures during the course of 2014/15, £12.0m of which has already matured and been replaced with long term loans. These loans may be replaced on a short term or long term basis depending on prevailing interest rates at the date of maturity. We will shortly be engaging with our treasury advisers to determine the best mix of borrowing periods.
- 3.3 As previously reported, the Council has been in an under-borrowed position for some time i.e. cash balances have been used to fund capital expenditure in place of borrowing. This has been beneficial as the loans fund interest rate has remained lower as a result. Previous Strategy reports proposed to translate some of this under-borrowing into long term loans on a gradual and managed basis. Consequently, the budgeted borrowing requirements of £51.6m per para 3.1, may still be required regardless of the slippage on the 2014/15 capital programme.
- 3.4 The Strategy Report highlighted the potential for four Market Loans, up to a value of £26m, to be repaid during the year should any of the lenders invoke a rate change clause as per their contracts. This has not occurred. The potential for repayment of any of the Market Loans remains low given the current structure of long term interest rates.
- 3.5 The PWLB has extended the "PWLB Certainty Rate" by a further year. This facility enables eligible local authorities to access discounted PWLB borrowing. Falkirk Council has submitted an application and awaits further instruction from the PWLB.

- 3.6 Given the latest outlook for the future direction of interest rates, as outlined in Section 2, it remains the case that funding of the longer term borrowing requirement will continue to be linked to short term rates. Although long term rates have dipped from those included in the Strategy Report they remain volatile given worldwide negativity such as the situations in Ukraine and Syria/Iraq.
- 3.7 Debt rescheduling activities remain on hold given the current structure of long-term interest rates which makes such transactions unattractive. This position is likely to persist until such time as the premature repayment rates for PWLB loans rise from their current levels.

#### **4. INVESTMENT STRATEGY**

- 4.1 Members are reminded that the primary objectives of the Council's investment strategy remain first and foremost to ensure timeous and full repayment of principal and interest, then securing adequate liquidity of funds invested and finally optimising investment returns consistent with counterparty risks.
- 4.2 The Council held £7.0m of investments available on instant access, in two UK banks at the end of October 2014.
- 4.3 The Strategy Report provided details of the counterparties that the Council engages with in terms of its investments. To assess counterparty risk, the Council makes use of credit rating information as published by the three credit rating agencies, Fitch, Moody's and Standard and Poors. The credit ratings supplied from these rating agencies, as reported in the Strategy, included a rating for the following:
- Short Term
  - Long Term
  - Viability/Financial Strength
  - Support
- 4.4 Recently, in response to the evolving regulatory regime, the main rating agencies have indicated that they may remove ratings "uplifts", based on implied levels of sovereign support. The Support, Financial Strength and Viability ratings will therefore become redundant. While the actual timing of the changes is still subject to discussion, the process may start before the end of this financial year. It is therefore sensible to pre-empt this change now and remove the Support, Financial Strength and Viability ratings.
- 4.5 It should be noted that this change does not reflect a deterioration in the credit rating of institutions, but simply reduces the number of criterion used to rate them. Appendix 1 details the amended counterparty criteria to be used following this change by the rating agencies.

4.6 National Australia Bank is looking at options for the future of the Clydesdale and Yorkshire banking division. One of the options being considered is the sell off of the Clydesdale Bank. Given the purely transactional nature of our dealings with Clydesdale Bank, it is not anticipated that the sale would have a significant impact on the Council. Updates will be reported back to Members in due course.

## 5. TREASURY MANAGEMENT PRUDENTIAL INDICATORS

5.1 Financing of the Capital Programme is a key driver of Treasury Management activities which in turn is managed by a series of treasury management prudential indicators.

5.2 The purpose of the indicators is to contain the activity of the treasury function within specified limits, thereby managing risk and reducing the impact of an adverse movement in interest rates.

(1) <b><u>Interest Rate Exposure</u></b> These limits set the maximum for fixed and variable interest rates based on the debt position net of investments and seeks to control the level of debt exposed to short term movements in interest rates.			
	<b><u>Position</u></b> <b><u>(31/10/14)</u></b>	<b><u>2014/15</u></b> <b><u>Limit</u></b>	
Limits on fixed interest rates based on net debt	99%	100%	
Limits on variable interest rates based on net debt	1%	40%	
(2) <b><u>Maturity Structure on Fixed Interest Rate Borrowing</u></b> These gross limits are set to control the Council's level of exposure to loans expiring in any one period.			
	<b><u>Position</u></b> <b><u>(31/10/14)</u></b>	<b><u>Lower</u></b>	<b><u>Upper</u></b>
	%	%	%
Under 12 months	4.8	0	25
12 months – 2 years	0	0	25
2 years – 5 years	0.5	0	50
5 years – 10 years	15.4	0	75
10 years – 20 years	34.4	0	75
20 years – 30 years	21.0	0	75
30 years – 40 years	15.0	0	75
40 years – 50 years	8.9	0	75
(3) <b><u>Maximum Principal Sum Invested &gt; 364 Days</u></b> As indicated in the Strategy Report, the Council does not place investments for periods longer than 364 days.			

## **6. MEMBER TRAINING**

- 6.1 The Investment Regulations provide for increased scrutiny by Members of treasury management issues. A training session tailored towards the needs and responsibilities of Members was delivered on 28 April 2014. The training session covered Capital and Treasury Management activities, specifically examining the regulatory framework and the scrutiny role of Members.

## **7. CONCLUSION**

- 7.1 The short term interest rates continue to remain low relative to the long term PWLB rates. Given our borrowing requirement we must remain vigilant to the factors affecting the movement in rates e.g. UK growth, Eurozone and US issues, and work closely with our treasury advisers to ensure that any borrowing is undertaken at the most advantageous rate possible.

## **8. RECOMMENDATIONS**

- 8.1 **Executive notes the progress of the Council's Treasury Management Strategy for 2014/15.**
- 8.2 **Executive notes the changes to the credit methodology in section 4 of the report.**
- 8.3 **Executive agree the report is referred to Council for consideration.**

**Chief Finance Officer**

**Date: 11 November 2014**

**Contact Officer: Carole McGhee**

### **LIST OF BACKGROUND PAPERS**

1. Treasury Management Strategy 2014/15 submitted to Council on 14 May 2014.

Any person wishing to inspect the background papers listed above should telephone Falkirk 01324 506340 and ask for Carole McGhee/Amanda Templeman.

**CREDIT AND COUNTERPARTY POLICIES**

Criteria to be used for creating/managing approved counterparty lists/limits.

- Chief Finance Officer in conjunction with the treasury management advisers, will formulate suitable criteria for assessing and monitoring the credit risk of investment counterparties and shall construct a lending list comprising period, type, sector and specific counterparty limits.
- The rating criteria will use the lowest common denominator method (across Fitch, Moody's and Standard & Poors) of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution.
- The Council will also have regard to additional operational market information such as negative rating watches/outflows before selecting the relevant counterparties.
- The Council's approved counterparty list will extend to selected counterparties from the following sectors:

UK Banks

Overseas Banks (but with UK authorisation) Minimum Sovereign rating of AA

Building Societies

UK Local Authorities

UK Government

- The minimum level of credit rating for an approved counterparty per Fitch ratings will be as undernoted, with particular reference to the short term rating but having regard to other ratings.

SHORT TERM	F1	Indicates the strongest capacity for timely payment of financial commitments within a 12 month timeframe
LONG TERM	A-	High Credit Quality. A low expectation of credit risk with a strong capacity for timely payment of financial commitments

- Part nationalised UK banking Groups – Lloyds Bank/Bank of Scotland and Royal Bank of Scotland/Nat West. These banks can be included if they continue to be part nationalised or they meet the ratings above.
- The maximum period for investments will be 3 months unless an alternative period is recorded against a specific counterparty.
- The maximum value for any one investment transaction will be £8 million unless a lesser amount is recorded against a specific counterparty.

- The Council's own banker (Clydesdale) will continue to be used for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised where possible and maintained in an instantly accessible call account.

Full individual listings of counterparties and their limits are shown below.

### **APPROVED COUNTERPARTIES AND COUNTERPARTY LIMITS**

Investments in the form of Temporary Deposits may be placed with the institutions noted below subject to the limit per institution indicated.

#### **UK BANKS**

<b><u>INSTITUTIONS</u></b>	<b><u>LIMIT</u></b>	<b><u>MAX PERIOD</u></b>
Santander UK	£8m	Call
Barclays Bank	£8m	3 Months
Clydesdale Bank	£8m	Call
HSBC	£8m	3 Months
Lloyds Banking Group *		
Lloyds TSB	£8m	3 Months
Bank of Scotland	£8m	3 Months
* A maximum combined monetary limit of	£8m	
Royal Bank of Scotland *		
Royal Bank of Scotland	£8m	3 Months
Nat West	£8m	3 Months
* A maximum combined monetary limit of	£8m	

#### **BUILDING SOCIETIES**

Nationwide	£5m	3 Months
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#### **UK LOCAL AUTHORITIES**

	£5m per LA	1 Year
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#### **UK GOVERNMENT**

	Unlimited	6 Months
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#### **MONEY MARKET FUNDS**

	£5m per fund	Call
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