AGENDA ITEM 6

FALKIRK COUNCIL

Subject:	**TREASURY MANAGEMENT INTERIM REVIEW 2015/16**
Meeting:	**FALKIRK COUNCIL**
Date:	**16 DECEMBER 2015**
Author:	**DIRECTOR OF CORPORATE AND HOUSING SERVICES**

1. PURPOSE OF REPORT

1.1 The purpose of this report is to refer the Treasury Management Interim Review for 2015/16 to Council.

2. BACKGROUND

2.1 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 by Council.

2.2 The Executive considered the attached report on the mid-year review on 1 December 2015 and agreed to refer it to Council for consideration.

3. RECOMMENDATION

3.1 **Council is invited to consider the Treasury Management Interim Review for 2015/16.**

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Director of Corporate and Housing Services

Date: 7 December 2015
Contact Officer: Brian Pirie (Tel: 01324 506110)

LIST OF BACKGROUND PAPERS

Nil

FALKIRK COUNCIL

Subject: **TREASURY MANAGEMENT – INTERIM REVIEW 2015/16**
Meeting: **EXECUTIVE**
Date: **1 December 2015**
Author: **DIRECTOR OF CORPORATE & HOUSING SERVICES**

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 2015/16 in May 2015. The Strategy highlighted that the UK economy appeared to be recovering with UK GDP growth of 2.9% estimated for 2015. The Strategy did advise caution highlighting that although the economy appeared to be recovering, it needed to move away from its dependence on consumer expenditure and the housing market to exports, particularly manufactured goods. Recent economic data has revised the GDP growth forecasts to 2.4% for 2015 and although lower than originally anticipated, it is still considered to be healthy. The slowdown although impacted by a fall in construction is mainly due to a decline in manufacturing output due to weak demand in the overseas market, particularly China. In contrast, unemployment fell to a seven year low of 5.4% in the three months to August 2015 (5.7% reported in the Strategy), and although GDP growth forecasts have been reduced, the increase in employment will continue to underpin the economic recovery. The inflation rate turned negative in September (-0.1%) with a smaller than usual rise in clothing prices and a fall in motor fuel costs being the main contributors. Economists predict that the rate will remain low and below the target of 2% well into 2017.

2.2 U.S. economic growth slowed sharply in the third quarter of the year with analysts suggesting that this is a temporary blip and growth is expected to accelerate again in the fourth quarter. There is still speculation about when the Federal Reserve will raise interest rates with some economists believing that this may be as soon as December. Within the Eurozone there are positive signs that the economy is recovering, helped by the ECB's quantitative easing programme. However, the Chinese and Japanese economic downturns may have a detrimental impact on this. A third bailout package for Greece has been agreed, but there are major doubts as to whether the austerity measures agreed by the Greek government can be fully implemented and as such a Greek exit from the Eurozone is still possible.

2.3 In the Strategy Report, there was an expectation that the Bank Rate would remain at 0.5%, until March 2016. However recent economic data is suggesting that the increase will take place in June 2016, marginally later than originally anticipated. Although the long term rates for 2015/16 are aligned with those reported in the Strategy Report, and the rates for 2016/17 and 2017/18 are marginally lower, they continue to be unstable.

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

		MONEY RATES		PWLB RATES			
Annual Average %	**Bank Rate**	**3 months**	**1 Yr**	**5 Yr**	**10 Yr**	**25 Yr**	**50 Yr**
2015/16	0.5	0.5	1.0	2.3	2.9	3.5	3.5
2016/17	0.8	0.9	1.4	2.7	3.4	4.0	4.0
2017/18	1.3	1.5	2.0	3.2	3.8	4.4	4.4

3. BORROWING STRATEGY

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

	2015/16 Original Estimate £m	**2015/16 Revised Estimate £m**
Capital Programmes (net of receipts including TIF)	37.1	36.0
Service Payments	(13.7)	(13.0)
Short Term Loans maturing in year	25.6	26.0
Total Longer Term Borrowing Requirement	49.0	49.0

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 £26.0m of short term debt that matures during the course of 2015/16. These loans may be replaced on a short term or long term basis depending on prevailing interest rates at the time borrowing is undertaken. Note that depending on cash flow balances, the replacement of these loans might not necessarily be undertaken at the date of maturity. We will shortly be engaging with our treasury advisers to determine the best mix of borrowing periods and the best time to borrow based on available interest rates.

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 £49.0m per para 3.1, may still be undertaken regardless of any slippage on the 2015/16 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's application for this facility has been approved.

3.6 In addition to the "PWLB Certainty Rate", the Council has been able to access further discounted borrowing under the "PWLB Project Rate Initiative". This initiative is aimed at projects which support local and national growth e.g. TIF and Denny Town Centre Regeneration. The level of borrowing available to the Council is c£7.0m, however take up will be dependent on the anticipated 15/16 spend for these projects.

3.7 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.

3.8 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 £27.3m of investments at the end of October 2015. Details are as follows:

Institution	**Investment (£'m)**	**Maturity**
UK Banks	7.1	Call
Money Market Funds	5.0	19/11/15
Local Authority	5.0	13/11/15
UK Building Society	10.2	Call
Total Investments	**27.3**	

As per para 3.2, £26m of short term loans mature during 2015/16, £12m of which are due to mature in November/December. The significant level of investments shown in the table above will dissipate as these short term loans mature and the cash flow requirements of the Council change over the course of November e.g. salary payments, creditors payment etc.

4.3 Members were previously advised that there would be a change in the ratings methodology adopted by rating agencies. This change has now been implemented and ratings for Viability, Financial Strength and Support have been removed and only Short and Long Term ratings will now be assessed. It should be noted that as previously advised, this 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 following this change by the rating agencies.

4.4 The Council has been granted the authority to borrow to on-lend to Registered Social Landlords (RSL). The maximum lending period is 15 years and the loan to the RSL is to be used to fund new affordable housing investment. The loan to the RSL may be funded by prudential borrowing or cash backed reserves

4.5 Members were previously advised that the National Australia Bank were looking at options for the future of the Clydesdale and Yorkshire banking divisions. A decision has now been made to sell off these divisions in the early part of 2016. The sale is unlikely to have any impact on the Council in the short term but going forward it will depend on who it is sold to and what their views are on providing banking services. We will be liaising with our Treasury advisers and Members will be advised of developments 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 these 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) **Interest Rate Exposure**

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.

	Position (31/10/15)	2015/16 Limit
Limits on fixed interest rates based on net debt	99%	100%
Limits on variable interest rates based on net debt	1%	40%

(2) **Maturity Structure on Fixed Interest Rate Borrowing**

These gross limits are set to control the Council's level of exposure to loans expiring in any one period.

	Position (31/10/15) %	Lower %	Upper %
Under 12 months	9.4	0	25
12 months – 2 years	0	0	25
2 years – 5 years	1.5	0	50
5 years – 10 years	13.9	0	75
10 years – 20 years	31.0	0	75
20 years – 30 years	22.1	0	75
30 years – 40 years	13.9	0	75
40 years – 50 years	8.2	0	75

(3) **Maximum Principal Sum Invested > 364 Days**

As indicated in the Strategy Report, the Council does not place investments for periods longer than 364 days.

6. LOANS FUND REVIEW

6.1 The Scottish Government is undertaking a review of local authority borrowing with the emphasis on the current borrowing regulations as they affect the repayment of loans fund advances. Currently 31 out of 32 Scottish Councils apply the annuity method to calculate the debt repayment chargeable to the Revenue budget. However the review requires Councils to make a prudent provision for the repayment of debt which could require a change in the calculation method from annuity to equal instalments of principal (EIA) method. The change in calculation method will not come into affect until 2021/22 and will only apply going forward so that historic borrowing could continue to be accounted for on an annuity basis if considered appropriate.

6.2 The difference between the two calculation methods is that in the short to medium term borrowing under the EIA method is more expensive, but cheaper over the term of the loan than the annuity method. Appendix 2 provides some comparisons between the two methods.

6.3 Whilst our borrowing requirement for both Housing and TIF projects is set to increase over the short to medium term, the same cannot be said of the General Fund. The current three year Capital Programme has sought to limit investment to available resources in order to reduce the impact on the Revenue budget and as such it is anticipated that there will be no detrimental impact because of this change in calculation method. However there would be an impact on HRA and TIF. Future reports to the Executive will update Members with any relevant issues as they develop.

7. SCRUTINY AND MEMBER TRAINING

7.1 Following an Audit Scotland National Report on Borrowing & Treasury Management in Councils, the Scrutiny Committee recommended to the Executive, that a review of borrowing and treasury management governance and methods of reporting be carried out. This review will be undertaken during 2015/16 and the findings reported back to Members in due course.

7.2 The Investment Regulations provide for increased scrutiny by Members of treasury management issues. The Scrutiny Committee recommended to the September Executive that Member Training in relation to treasury management should be mandatory for all Members before they are eligible to serve on the Executive, Scrutiny or Audit Committees. This recommendation was subsequently approved by Council and training is now scheduled to take place in March 2016.

8. CONCLUSION

8.1 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.

9. RECOMMENDATIONS

The Executive is invited to:

9.1 **Note the progress of the Council's Treasury Management Strategy for 2015/16.**

9.2 **Note the potential to on-lend to Registered Social Landlords in section 4 of the report.**

9.3 **Note the potential revenue impact of the Loans Fund review per section 6 of the report.**

9.4 **Note the recommendations from Scrutiny Committee per section 7 of the report.**

9.5 **Agree the report is referred to Council for consideration.**

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Director of Corporate & Housing Services
Date: 2 November 2015
Ref: AAB011215 – Treasury Management – Interim Review 2015-16
Contact Officer: Carole McGhee

LIST OF BACKGROUND PAPERS

1. Treasury Management Strategy 2015/16 submitted to Council on 13 May 2015.

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

APPENDIX 1

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

INSTITUTIONS	LIMIT	MAX PERIOD
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
UK LOCAL AUTHORITIES	£5m per LA	1 Year
UK GOVERNMENT	Unlimited	6 Months
MONEY MARKET FUNDS	£5m per fund	Call

APPENDIX 2

LOANS FUND REVIEW

Assumptions

Advance - £20m

Interest Rate – 4.10%

Repayment Term – 20 years

Year	EIA Repayment	Annuity Repayment	Variance
	£’000	£’000	£’000
1	1,820	1,485	335
2	1,779	1,485	294
3	1,738	1,485	253
4	1,697	1,485	212
5	1,656	1,485	171
6	1,615	1,485	130
7	1,574	1,485	89
8	1,533	1,485	48
9	1,492	1,485	7
10	1,451	1,485	(34)
11	1,410	1,485	(75)
12	1,369	1,485	(116)
13	1,328	1,485	(157)
14	1,287	1,485	(198)
15	1,246	1,485	(239)
16	1,205	1,485	(280)
17	1,164	1,485	(321)
18	1,123	1,485	(362)
19	1,082	1,485	(403)
20	1,041	1,485	(444)
TOTALS	**28,610**	**29,700**	**(1,090)**